

**Quarterly Report**  
**01 January 2015 - 31 March 2015**

*Prepared by IBSER under grant*

*# AID-121-A-11-00006*

Kyiv

04/15/2015

## Abbreviations

AFO	Association of Financial Officers of Ukraine
AUC	Association of Ukrainian Cities
CLC	Commercial Law Center
CPER	Combined Program Evaluation and Review
DHA	District Heating Assessment
EC	European Commission
ESCO	Energy Servicing Company
EU	European Union
FAF	Foreign Assistance Framework
GOU	Government of Ukraine
HCSS	Housing and Communal Services Sector
IBSER	Institute for Budgetary and Socio-Economic Research
LG	Local Government
LINC	Local Investment and National Competitiveness
MBR	Municipal Budget Reform
MFF	Municipal Finance Facility
MFSI	Municipal Finance Strengthening Initiative
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NGO	Non-Governmental Organization
OSR	Own-source Revenues
PFR	Public Finance Review
PMP	Performance Monitoring Plan
PPB	Performance Program Budgeting
RTI	Research Triangle Institute
SEFR	Support for Economic and Fiscal Reform
TSA	Treasury Single Account
USG	United States Government
WB	World Bank

## Executive Summary

### *PUBLICATIONS AND REPORTS*

- MFSI-II Project analysts prepared the publication, *Budget Monitoring for January–December 2014*, drawing from the Treasury Department’s preliminary data. The document includes analyses of the latest State and local budget execution trends and relevant legislative acts approved during the reporting period.
- The Project prepared three monthly monitoring reports on the implementation of the State and local budgets for the period of November 2014 through January 2015.
- MFSI-II experts prepared the annual PPB experiment progress reports. In 2014, the participants in the experiment approved more than 36,000 budget programs, including 4,800 with budget saving indicators. They generated more than UAH 1.1bn in savings.
- MFSI-II experts analyzed the energy expenditures of six selected cities (Sumy, Komsomolsk (Poltava region), Chernivtsi, Artemivsk, Kirovohrad and Berdychiv).
- MFSI-II experts prepared a report on the number of trainings held and the number of specialists who participated in trainings with a breakdown by gender and by municipal enterprise.
- MFSI-II experts developed a preliminary version of a manual on EITI implementation in Ukraine.
- MFSI-II experts prepared analysis of the amendments to the Budget Law for the respective year.
- MFSI-II experts prepared analysis of the amendments to the Budget Code.

### *MEETINGS AND TRAINING*

- Under the auspices of the Ministry of Finance, the MFSI-II experts have launched a series of regional trainings on practical implementation of changes to the Budget Code of Ukraine with regard to the inter-budget relations reform and introduction of PPB for local budgets. In the reporting quarter, such trainings were delivered in the Cherkasy, Chernivtsi, Kirovohrad, Rivne, and Zhytomyr oblasts.
- In the reporting period, experts of the MFSI-II Project completed delivering a series of regional PPB trainings based at the Kirovograd and Kyiv Regional Retraining and Qualifications Enhancement Centers.
- On 10 February 2015, a joint meeting of the representatives of MOF, heads of local financial authorities, and the National Advisory Board on the issues of effective public finance management was held at the Ministry of Finance of Ukraine. The participants discussed at the meeting the topical issues of implementing the reform of the budget system of Ukraine. Department directors of the Ministry of Finance described the key aspects of the legislative changes, which occurred in the budget legislation, and provided clarifications with regard to interpretation of new provisions of the Budget Code.
- Upon invitation of the State Agency on Energy Efficiency and Energy Saving (Derzhenergoefektyvnosti), on 17 January 2015, experts of the MFSI-II Project took part in a meeting on finalizing the legislative drafts on opportunities for attracting the private capital into energy saving activities in the public sector.

- On 28 January 2015, MFSI-II experts delivered a training for representatives of the Mykolaiv oblast NGOs on the issues of formulation and execution of local self-government budgets. The training was attended by the representatives of 30 nongovernmental organizations from the Mykolaiv oblast. The training focused on the problem issues of formulation and execution of the budgets of the territorial communities of villages, settlements, and cities of raion subordination.
- Experts of the MFSI-II Project took part in finalizing the legislative drafts passed in the first reading by the Verkhovna Rada of Ukraine on 5 February 2015, which would remove the main barriers to attracting private capital for reducing energy consumption by government-funded institutions. One of the legislative drafts intended for this purpose involves amendments to the Budget Code in whose development the MFSI-II experts participated directly.
- On 20 February 2015, MFSI-II experts took part in a seminar entitled *Requirements for Filling out a Report According to the Rules of the Extractive Industries Transparency Initiative in Ukraine (EITI)* organized by the Tax Consultants' Chamber NGO. According to EITI, both companies and the Government must disclose the information about the payments for use of natural resources and make sure that such proceeds are used for the benefit of citizens.
- On 13 March 2015, the MFSI-II Project took part in a working meeting with the Ministry of Energy and Coal Industry of Ukraine (MoECI) with regard to the Extractive Industries Transparency Initiative (EITI). The meeting focused on the main tasks MoECI is facing in implementing EITI and the assistance the Ministry is expecting from the Project in the immediate future.
- On 13 March 2015, a working meeting was held between MFSI-II experts and representatives of the Kyiv City Council and Kyiv City State Administration. The meeting discussions focused on opportunities for implementation of a *Citizens' Budget* in the city of Kyiv. Opportunities were discussed at the meeting for the formulation of city's budget in a format comprehensible for the general public. Based on the meeting results, areas for further collaboration were set up.
- On 20 March 2015, experts of the MFSI-II Project took part in a meeting of the Committee on Budget of the Verkhovna Rada of Ukraine devoted, among other things, to finalizing the amendments to the Budget Code adopted in the first reading, which amendments are required for removing the main barriers in attracting private capital for reducing energy consumption by government-funded institutions.
- On 27 March 2015, MFSI-II experts delivered the training workshop *Effective Planning and Evaluation, Including Those for Energy Performance Projects, as the Guarantee for Achievement of Strategic Objectives*. The event was attended by the representatives of municipal utilities and executive committees of the city councils, which participate in the Project, namely from Kyiv, Kryvyi Rih, Komsomolsk (Poltava Oblast), Slavutych, Chernivtsi, Sumy, Berdychiv, and Kirovohrad. In the course of the seminar, the MFSI-II experts introduced the participants to the proposals for improving the effectiveness of financial justification of strategic documents by municipal utilities in the context of city development priorities, and familiarized them with the methodology of monitoring and evaluation of energy performance projects.
- On 31 March 2015, upon invitation of the Ministry of Energy and Coal Industry of Ukraine, experts of the MFSI-II Project took part in a scheduled meeting of the Multi-Stakeholder Group (MSG) on implementation of the Extractive Industries Transparency Initiative (EITI) in Ukraine.

#### *DRAFT AMENDMENTS AND RECOMMENDATIONS*

- On 5 February 2015, the Verkhovna Rada of Ukraine passed in the first reading a Draft Law of Ukraine "On Amending the Budget Code of Ukraine" (regarding introduction of new investment opportunities, guaranteeing the rights and lawful interests of economic entities in implementing

large scale energy modernization), Reg. No. 1409 of 11 December 2014, which was developed with participation of MFSI-II Project experts. The draft law also stipulates financial incentives to promote the establishment of an effective energy savings system in the public sector, in particular, due to enabled retaining in the budget a part of savings coming from energy-efficiency activities even before completing the settlements with a private partner under them.

- Based on the analysis findings of the energy expenditures of six selected cities (Sumy, Komsomolsk (Poltava region), Chernivtsi, Artemivsk, Kirovohrad and Berdychiv), the MFSI-II experts have developed recommendations for the Project cities.

## List of major activities for the next quarter

### PUBLICATIONS AND REPORTS

- MFSI-II will prepare report on the results of the monitoring and evaluation of PPB-based budget programs
- MFSI-II will prepare handbook on specifics of local budgets formation
- MFSI-II experts will prepare analysis of the Budget Declaration for the next year
- MFSI-II will prepare three monthly monitoring reports on the State and local budgets for the period from February 2015 to April 2015.
- By the end of the next quarter, MFSI-II experts intend to draw up a publication *“Budget Monitoring for January- March 2015.”*
- MFSI-II will prepare analysis of the legislative and methodological framework for internal oversight and audit at the national level.
- MFSI-II experts will update the system for monitoring energy-related budget expenditures for the four selected cities.
- MFSI-II experts will represent the Updating Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector at a session of the Financial and Economic Forum, after adoption of the amendments to the Budget Code, development and approval of the statutory instruments intended for attracting private capital for reduction of energy consumption by government-funded institutions.
- MFSI-II experts will provide consultations on Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector, including for development of budget programs and individual investment projects.
- MFSI-II experts will provide consultations to the staff of municipal enterprises on using the methodology of Planning and evaluation efficiency, including those of energy saving projects, as a guarantee of achievement of strategic objectives.

### MEETINGS AND TRAININGS

- A National Advisory Board meeting is scheduled for June 2015.
- Preparation and organization of the Financial-Economic Forum in February 2015.
- MFSI-II experts and the Ministry of Finance of Ukraine will continue working together to implement PPB at the local budget level.
- MFSI-II experts will train MSG members and relevant non-member civil society organizations on EITI implementation in Ukraine

### DRAFT AMENDMENTS AND RECOMMENDATIONS

- MFSI-II will prepare proposals for improving the methods of monitoring and evaluation of local PPB-based budget programs
- MFSI-II will prepare proposals on improvements in the software for PPB which is used by the State Treasury

- MFSI-II experts will consult the staff of municipal enterprises on using the methodology for monitoring and evaluating the energy performance projects and improving the efficiency of the financial justification of strategic documents by utility enterprises.
- MFSI-II experts will participate in the development of regulations to implement the legislation (upon acceptance) on attracting private capital in energy-saving measures in the public sector, which in particular provides for financial incentives to promote the establishment of an effective energy savings system in the public sector.

## Key Milestones and Major Deliverables Summary

### **Objective 1: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine**

- Report on the number of trainings held and the number of participants attending the trainings with a breakdown by sex  
*Timeline: March 2015*
- Annual experiment progress reports  
*Timeline: March 2015*
- Analysis of the amendments to the Budget Law for the respective year is prepared  
*Timeline: March 2015*
- Analysis of the amendments to the Budget Code  
*Timeline: February 2015*

### **Sub-objective A.1: Ensure institutional sustainability of the training program(s) on the new budget legislation and PPB**

- A report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender  
*Timeline: October 2014 – March 2015*

### **Objective 2: Develop and introduce financial practices that foster energy efficiency in 15 selected cities**

- System for monitoring energy-related budget expenditures for the four selected cities  
*Timeline: April – June 2015*
- Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector are updated and presented at a session of the Financial and Economic Forum.  
*Timeline: October 2014 – March 2015*
- Consultations to the staff of municipal enterprises on using the methodology provided  
*Timeline: October 2014 – March 2015*
- Consultations on system implementation provided to the cities, including for development of budget programs and individual investment projects (or with regard to other mechanisms of ensuring energy efficiency in the public sector).  
*Timeline: October 2014 – March 2015*



**Objective 3: Enhance public awareness of the budgeting process, revenues and expenditures, support and promote the “Citizens” Budget”**

- Monthly monitoring of national and local budget implementations  
*Timeline: second week of every month*
- Monitoring of the fiscal impacts on local budgets in the form of a full-scale analysis of the budget process  
*Timeline: 31 March 2015*
- Preparation and organization of the National Advisory Board  
*Timeline: 10 February 2015*
- Preparation of an electronic bulletin  
*Timeline: January 2015*
- Publication «Innovative Practices of the Local Finance Management»  
*Timeline: March 2015*
- Support the holding of separate information public events in partner cities  
*Timeline: 23 February 2015*
- Delivery of training on budget issues for NGOs  
*Timeline: 28 January 2015*

**Objective 6: Assist in implementation of the Extractive Industries Transparency Initiative (EITI) in Ukraine**

- Develop a manual on EITI implementation in Ukraine and have it placed on the Project website  
*Timeline: March 2015*

## Tasks and Subtasks

***Objective 1: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine***

**Task 1.1: Provide assistance to the GOU (Ministry of Finance, State Treasury of Ukraine, local finance departments, key spending units) in piloting government-supported PPB programs and implementing them in the Ukrainian local budgets**

***Sub-task 1.1.1: Improve the monitoring and evaluation of the execution of local budget programs for all the local government functions***

IBSER developed the draft methodology for monitoring and evaluating the efficiency of budget program performance (including energy saving actions and the improvement of the natural environment). The said proposals were considered at a meeting of the NAB on December 28, 2011, which was attended by members of Parliament, experts of the Verkhovna Rada Budget Committee and other parliamentary committees, Ministry of Finance, and local governments.

The revised methodology was submitted in January 2012 to the Ministry of Finance. The Ministry of Finance of Ukraine forwarded the formula-based methodology developed by IBSER to all participants of the national experiment of PPB implementation under its letter No.31-05010-14-8/4651 dated 13 February 2013.

MFSI-II experts have piloted the methodology of comparative analysis of budget programs based on reporting data of local budgets. More than 750 budget programs of oblast, raion, and city budgets executed in 2012 passed through this evaluation. The results were presented by MFSI-II experts at a joint meeting of the Interdepartmental Working Group and the National Advisory Board on effective management of public finance, which took place on 25 June 2013.

MFSI-II experts have tested the updated methodology of comparative analysis of efficiency of budget programs based on the Zhytomyr city budget reporting data. More than 80 budget programs, which were implemented in 2013, have passed through the evaluation. The testing results have made it possible to prepare new proposals for improving the methodology of comparative analysis of efficiency of budget programs.

During the fourth year of implementation, MFSI-II will improve (if needed) the current benchmarking framework for the efficiency of budget programs performed by local budget spending units. The said proposals will be considered at a roundtable and a meeting of the NAB, involving members of the Parliament, experts from the budget and other parliamentary committees, Ministry of Finance, and local governments.

After that, the approved methodology will be submitted to the Ministry of Finance for approval and distribution among all the local budgets.

***Deliverable: An improved methodology for PPB-based monitoring and evaluation of the performance of budget programs (if needed)***

***Timeline: April – June 2015***

*Deliverable: Minutes subsequent to a roundtable or a meeting of the NAB*

*Timeline: June 2015*

*Deliverable: Reports on findings of PPB-based monitoring and evaluation of the performance of budget programs.*

*Timeline: March – June 2015*

***Sub-task 1.1.2: Complete the legislative, regulatory and methodological framework taking into account the specifics of PPB implementation at various levels of local budgeting***

In 2011-2013, the Government of Ukraine reviewed proposals prepared by MFSI-II experts for amending the Principal Normative-Legal Act, which regulates the use of PPB methodology at the local level. These proposals are reflected in amendments to the Ministry of Finance (MOF) Order No.679 "On Certain Issues of Conducting an Experiment of Implementation of the Performance Program Budgeting Method of Formulation and Execution of Local Budgets" dated 8 June 2012, No.690, and dated 26 November 2012, No.1221, and registered by the Ministry of Justice of Ukraine.

MFSI-II experts have prepared and submitted to MOF the amendments to MOF Order of 14 February 2012, No. 97 "On Approving the Structure of the Code of Program Classification of Expenditures and Crediting of Local Budgets and the Codifier of Numbering of Standard Lists of Local Budget Programs." The amendments were approved by MOF orders of 4 October 2011, No.1249, of 15 October 2012, No.1101, and of 20 December 2012, No.1386.

MFSI-II experts have reviewed the existing regulatory and legislative framework required for PPB implementation in local budgets and prepared proposals for its improvement. These proposals were submitted for consideration of the participants in the meeting of the National Advisory Board (NAB) on effective public finance management, which was held on 4 October 2013. The participants have supported every proposal made by the MFSI-II Project.

Amendments have been enacted to the Standard lists of budget programs and performance indicators for the delegated functions in the departments of Public Administration, Social Protection and Social Security, Social Protection of Family and Children, and Physical Culture and Sport, as well as similar provisions for the disbursement of expenditures for the implementation of own functions of local budgets. These amendments have been approved by orders of the Ministry of Finance and line ministries (No.1116/673 of 24 October 2012; No. 1060/630 of 8 October 2012; No.1202/1291 of 19 November 2012; No. 1035 of 27 September 2012; and No.35/41 of 22 January 2013). In addition, the experts provided their proposals to modify the Standard lists of budget programs and the performance indicators for the expenditures in the departments of youth and culture. The issued orders incorporate all the proposals made by MFSI-II experts with regard to reducing the number of budget programs and their performance indicators.

MFSI-II experts developed a standard program classification of expenditures and crediting of local budgets and a comparative table of its correspondence to the existing provisional classification of expenditures and crediting of local budgets. New approaches to program classification of local budgets were approved at a joint meeting of the Task Force on Interbudgetary Relations Reform and the National Advisory Board on Effective Management of Public Finance, held on 25 June 2013. The meeting participants recommended modifications to all documents used in the budget process. The amendments were approved by the MOF order No.705 of 26 July 2013.

Experts of the MFSI-II Project suggested a full-scale implementation of PPB methodology when formulating the budget programs aimed at improving the environmental situation in the regions and health of the population. To this end, the MFSI-II experts developed performance indicators which will evaluate the impact of budget programs on atmospheric air, water resources, green plantations, forestry, land reclamation, conservation of the natural and reserve fund, health of the population, etc. These

indicators were discussed on 4 October 2013 at a meeting of the National Advisory Board (NAB) on Effective Public Finance Management, were further reviewed by the Interdepartmental Working Group, and later entered into a supervised directive of the Ministry of Finance.

The key vectors of further work were reviewed on 6 June 2014, at a meeting of the National Advisory Board on efficient public finance management. Also, discussed at the meeting were the proposals of MFSI-II experts with regard to amending the key document of PPB for local budgets, i.e., the Order of the Ministry of Finance of Ukraine dated 9 July 2010, No.679. The meeting participants approved the materials developed and noted that the proposals made by MFSI-II experts are formulated with due account for special features of execution of local budgets at different levels, as well as possibilities of the transition to a fully-fledged implementation of PPB planning and execution of local budgets at all levels.

In order to implement the State support of the PPB methodology for all oblast, district and oblast-significant municipal budgets, MFSI-II will:

- help draft regulatory and legislative amendments required to complete the implementation of PPB for budgets of unions of local communities to be created under the law.
- help draft regulatory and legislative amendments required to complete the implementation of PPB for lower-level spending units and budget recipients.
- prepare draft (if needed) amendments to the joint orders of MOF and line ministries that approve the sample lists of budget program and their performance indicators for all the local budget functions.

*Deliverable: Proposals that amend to the Budget Code and other pieces of legislation as needed to complete PPB implementation for the budgets of associations of territorial communities, which will be established according to legislation developed*

*Timeline: October 2014 – September 2015*

In order to implement the government support for the PPB methodology at all levels of local budgets, on 2 December 2014 the Ministry of Finance of Ukraine passes two orders, which accommodated the MFSI-II experts' proposals on improving the approaches to performance program budgeting (PPB) in local budgets.

Order No. 1194 amended to the Main Approaches to Implementation of the Performance Program Budgeting Method for the Formulation and Execution of Local Budgets (the Ministry of Finance Order No. 805 dated 02 February 2010). The Ministry of Finance has determined that from 2015 a fully featured PPB in local budgets shall be applied following a decision of the respective local council. In other words, next year the PPB-based formulation and execution of local budgets will turn from a pilot to the main method of budgeting only in those local budgets, where a respective decision is made by the local councils, as regulated by the Budget Code of Ukraine.

Order No. 1195 approved a new sample program classification of expenditures for local budgets at all levels and a new code structure of the program classification of expenditures and crediting of local budgets. The amendments made aim to ensure unified approaches to the implementation of performance program budgeting at all the levels of local budgets. This will ensure reliable reporting on the execution of budgets of all the levels and contribute to higher transparency in the budget process as a whole.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

MFSI-II experts continued their efforts to improve the legislative framework, which regulates the performance program budgeting of local budgets. Working meetings were held with specialists of the Ministry of Finance and the State Treasury Service on improving the performance program budgeting of

local budgets through engaging in this process the budgets of the amalgamated territorial communities, which will be established according to the law and a prospective plan for the formation of community territories.

*Deliverable: Proposals that amend to the Budget Code and other pieces of legislation as needed to complete PPB implementation for lower-level spending units and recipients of budget funds developed*

*Timeline: July – September 2015*

*Deliverables: Proposals amendments to the joint orders of MOF and line ministries that approve the sample lists of budget programs and their performance indicators for all the local budget functions (if needed)*

*Timeline: October – December 2014 and April – September 2015*

As of now, the work on drafting amendments to the standard lists of budget programs and their performance indicators was suspended by the Ministry of Finance of Ukraine.

***Sub-task 1.1.3: Develop formats and procedures for treasury-based services of local budgets to improve the budget software used by the State Treasury; field-test these products within the local governments that have been a part of the pilot program***

During the first – third years of project implementation, the MFSI-II experts have reviewed the existing reporting forms on execution of local budgets, which are compiled by the State Treasury of Ukraine. The analysis has shown that these reports need amending in the context of PPB budgeting, namely: it is necessary to take into account the special circumstances of execution of local budgets using the codes of program classification of expenditures and crediting of local budgets.

The special features in generation of reports according to PPB were brought for consideration of the members of the National Advisory Board on efficient public finance management and approved at the meeting of 27 April 2012. Based on the results of this work, the IBSEER proposals for improving the reporting forms on execution of local budgets, which are compiled by the State Treasury Service of Ukraine, have been developed and submitted to the Ministry of Finance of Ukraine.

Proposals of MFSI-II experts were incorporated into the modification of forms of financial and budget reports on execution of local budgets approved by Order No.14 of the Ministry of Finance of Ukraine dated 16 January 2013.

The Order of the Ministry of Finance dated 25 November 2012, No. 1126 “On amending the Order of the Ministry of Finance of Ukraine of 30 January 2012, No. 60” approved amendments to the forms of budget reports on execution of local budgets, which incorporate the proposals made by MFSI-II experts with regard to improving the existing reporting forms on execution of local budgets.

MFSI-II experts completed work of improving the unified financial and budgetary reporting forms on execution of local budgets, which are compiled by the State Treasury Service of Ukraine.

This issue was discussed at a meeting of the National Advisory Board on efficient public finance management on 6 June 2014.

To implement the decision of the National Advisory Board, the MFSI-II experts finalized the budget reporting forms on execution of local budgets and prepared their proposals for making the appropriate amendments. The proposals take into account special features of execution of local budgets of different levels using the codes of program classification of expenditures and crediting of local budgets, as well as the standard program classification of expenditures and crediting of local budgets / provisional



classification of expenditures and crediting of the local budgets, which are not using PPB.

The proposed amendments provide for assuring common approaches to the formation of reports on execution of local budgets at all levels.

The proposals have been submitted to the Ministry of Finance of Ukraine.

Within the fourth year of implementation, should amendments be made to the PPB methodology for local budgets, MFSI-II will

- prepare proposals for improving the procedures for the treasury servicing of local budgets. It will submit proposals with regard to such amendments to the legislative framework that defines Treasury functions.
- draw up proposals on improvements in the software for PPB which is used by the State Treasury. All outputs will be furnished with the NAB for consideration and approval.

*Deliverables: The proposals for improving the procedure for the treasury servicing of local budgets developed. The proposals with regard to amendments to the legislative framework, which defines Treasury functions developed (if needed)*

*Timeline: October – December 2014*

MFSI-II experts completed the work on improving the regulatory and legal framework to improve the procedures for treasury services focused on the PPB-based local budgets.

In the reporting quarter, thanks to the work of the Treasury specialists, amendments were drawn up for the registration and accounting procedure for budget obligations of the budget spending units and recipients with the State Treasury Service, and to the procedure for preparation of financial statements and budget reporting by the budget spending units and recipients. The MFSI-II experts submitted proposed amendments to these documents; the possibility of transition to a fully functional PPB was considered. All proposals were incorporated in the orders of the Ministry of Finance of Ukraine.

During Project implementation, the MFSI-II experts elaborated almost all regulations governing the treasury services for local budgets and preparation of the budget execution reporting. As a result, proposed amendments to the relevant documents were submitted to the State Treasury Service. So, the proposals prepared by the MFSI-II experts were included in the amendments to the following orders of the Ministry of Finance:

- Order No. 938 dated 23 August 2012 “On Approval of the Procedure for Treasury Services to Local Budgets;”
- Order No. 60 dated 30 January 2012 “On Organization of the Local Budget Performance Reporting by the State Treasury Service of Ukraine;”
- Order No. 44 dated 24 January 2012 “On Approval of the Procedure for the Preparation of Financial Statements and Budget Reporting by Budget Spending Units and Recipients;”
- Order No. 309 dated 02 March 2012 “On Approval of the Procedure for the Registration and Accounting of Budget Obligations of Budget Spending Units and Recipients with Bodies of the State Treasury Service of Ukraine.”

The proposed changes were meant to provide for unified approaches for the treasury execution of local budgets and form transparent and reliable consolidated statements in the event of implementation of performance program budgeting in terms of formulation and execution of local budgets.

Currently, there is no need to make additional amendments to the legal framework that defines the functions of the Treasury.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

*Deliverables: Proposals on improvements in the software for PPB which is used by the State Treasury*

*Timeline: January – June 2015*

MFSI-II experts continued their work of improving the software used by the State Treasury Service for servicing local budgets. The proposals for amending the orders of the Ministry of Finance were prepared and discussed with specialists of the Treasury during working consultations, which proposals will make it possible to improve the software that supports servicing of local budgets and generation of reports on their execution.

#### ***Sub-task 1.1.4: Prepare and disseminate a handbook on specifics of local budgets formation***

In 2011, MFSI-II experts prepared a *Modern Tools of Financial Planning* handbook, which contains the training, normative, and methodological materials needed for learning the methods and applying the practices of local budget planning based on Performance Program Budgeting. The methodology of financial justification of strategic documents and principles of financial analysis of investment projects are provided.

In 2011-2013, MFSI-II experts prepared and updated 4 versions of the *Planning of Local Budgets Based on the Performance Program Budgeting Method* handbook, which contains the training, normative, and methodological materials required for studying the methods and applying the practices of local budget planning based on the Performance Program Budgeting method. This handbook reflects all the latest changes in the PPB legislation.

An electronic version of this handbook has been prepared for ease of use. Its use will help improve the knowledge of local-level specialists about the modern tools of financial planning. The electronic version of this handbook will be disseminated during PPB trainings for local offices of the State Treasury and local finance departments.

During the fourth year of implementation, MFSI-II will develop a handbook on specifics of local budgets formation which will cover the most recent legislative changes in terms of planning local budgets, including performance program budgeting, the new framework of inter-budget relations and specifics of formation of local budgets of different levels. The handbook will have a section dealing with methods for formulation of measures on energy efficiency, environment remediation and/or health improvement. A special emphasis will be made to highlight gender equality of all the budget process participants.

The handbook will be meant for managers and specialists of local governments and authorities, companies, financial institutions, and other stakeholders. MFSI-II will disseminate it as part of the training activities and place its soft copy on the MFSI-II Project's website.

*Deliverable:* *A handbook on specifics of local budgets formation developed, disseminated and placed on the website*

*Timeline:* *June 2015*

#### ***Sub-task 1.1.5: Assess the need for additional training on the new budget legislation and PPB in the municipalities that participated previously in the Municipal Budget Reform (MBR) Project***

80 Ukrainian cities participated in the Municipal Budget Reform Project. According to the MOF Order #805 of 2 August 2010 "On Approving the Main Approaches to Implementation of the Performance Program Budgeting Method of Formulation and Execution of Local Budgets," all oblast-subordinated

Ukrainian cities should take part in the State experiment of PPB implementation. MFSI-II experts have delivered training and provided PPB consultations for these cities. All oblast-subordinated cities have been preparing their budgets in the PPB format on an experimental basis since 2011.

The participants of the Municipal Budget Reform Project only included six raion-subordinated cities, which are not participating in the experiment at this time. These are Trostyanets', Borshchiv, Buchach, Kiverts', Kaharlyk, and Skvyra. To examine the status of PPB implementation and their willingness to collaborate, IBSEER have prepared and sent out questionnaires to these cities.

MFSI-II experts have analyzed the data of the questionnaires returned by the cities participating in the Municipal Budget Reform Project. The representatives of the towns Trostyanets' and Buchach expressed their wish to learn more about the PPB methodology and take part in trainings. IBSEER forwarded methodological materials to these cities and is working with the municipal leaders to agree the training dates.

Within the fourth year of implementation, IBSEER will develop a questionnaire and conduct an analytical survey of the municipalities that participated in the Municipal Budget Reform Project, which will then be used for assessing the status of using the PPB methodology and the need for conducting special training sessions training on the new budget legislation and PPB in such municipalities (to be conducted under Sub-task 1.1.6).

***Deliverable:** An analytical memo describing the results of surveying the municipalities that participated in the Municipal Budget Reform Project*

***Timeline:** January – March 2015*

All the oblast-subordinated cities of the Municipal Budget Reform Project were formulating their budgets in the PPB format on a pilot basis in the period of 2011 through 2014. According to amendments to the Budget Code of Ukraine (dated 28 December 2014, No.79-VIII), the mandatory use of the performance program budgeting method is required for the local budgets, which have mutual relations with the State budget, starting with preparation of draft local budgets for the year 2017. At present, appropriate training is being provided to these cities as part of implementation of Subtask 1.1.6.

The group of the Municipal Budget Reform Project cities included only six raion-subordinated cities, which took no part in implementation of the PPB pilot.

***Deliverable:** Special trainings for the municipalities that participated in the Municipal Budget Reform Project (if needed)*

***Timeline:** April – June 2015*

***Sub-task 1.1.6: Train budget officers from local finance departments, key spending units, as well as local departments of the Treasury***

In order to efficiently implement PPB at the local level, it is necessary to improve the qualifications of the personnel of local finance departments, the specialists of the spending units and recipients of budget funds, as well as of the representatives of regional and local offices of the State Treasury. Thus, since the project launch, the MFSI-II experts have conducted a series of similar PPB trainings. Such trainings were delivered in all oblast centers for specialists of each region. Overall, 6,735 local-level specialists (without studying within Sub-task A.1) passed through this training, including 5,911 women and 824 men.

Also, a number of legislative initiatives aimed at changing the budget framework are currently proposed in Ukraine. Quite often, people in the regions do not understand and, therefore, do not accept the proposed changes. This, primarily, is indicative of a very poor level of outreach with local governments in communicating the key provisions of the developed changes. Therefore, should such a



need arise, MFSI-II will assist the Ministry of Finance in arranging for clarification of provisions of the new legislation and conduct the relevant trainings for local government officials.

At the regional level, during the fourth year of MFSI-II project implementation, will keep on delivering a series of cluster trainings training on the new budget legislation and PPB. A cluster will include various local budgets from one oblast. Thus, as a contrast to the departmental approach, a group of local budgets that are homogeneous in terms of their type and function will be selected.

For the trainings training on the new budget legislation and PPB, MFSI-II will make use of the handbook to be developed under Sub-task 1.1.4. Participation in them will be equally offered for women and men.

*Deliverable: A report on the number of trainings held and the number of trainees, with a breakdown by gender*

*Timeline: January – September 2015*

Under the auspices of the Ministry of Finance, MFSI-II experts have launched a series of regional training events on practical implementation of the amendments to the Budget Code of Ukraine with regard to the inter-budget relations reform and PPB implementation for local budgets. The training seminars have been designed specifically for the heads and staff of local financial authorities of all levels, as well as for key spending units.

According to the schedule agreed with the Ministry of Finance, trainings were held in the reporting quarter in the Cherkasy, Chernivtsi, Kirovohrad, Rivne, and Zhytomyr oblasts.

All in all, 306 local specialists passed through training in the reporting quarter, including 51 men and 255 women.

By the end of the first six months of 2015, such trainings will be delivered in another 11 oblasts of Ukraine. Thanks to this work, the specialists of local financial authorities will have an opportunity to learn about the latest changes in the budget legislation and discuss the topical issues of implementation of the budget system reform in Ukraine.

See folder “Deliverables”

**A regional training on practical implementation of amendments to the Budget Code of Ukraine and PPB, City of Rivne, 27 March 2015**



### ***Sub-task 1.1.7: Provide advisory support to the local governments that have not been involved in the PPB pilot project***

During the first – third years, IBSER developed the existing local network of consultants who will help introduce PPB budgeting and will facilitate coordination between participants in the process. To implement the tasks of the fourth year of implementation, MFSI-II will advance the current local network of advisors who will help in the clarification of the new legislative provisions and implementation of PPB and facilitate coordination between the participants to this process. They will also collect, synthesize and submit to the Ministry of Finance for consideration the most important issues, and also facilitate dissemination of recommendations on their resolution in the regions.

Specialized training will be delivered in a systemic fashion to enhance qualifications of the MFSI-II advisors.

MFSI-II will further maintain the website's column "Current Issues of PPB" and introduce a new column "Expert Answers on the Specific of Local Budgets Formation" where visitors will have an opportunity to get answers to their queries in interactive communication.

*Deliverable: Annual experiment progress report*

*Timeline: March 2015*

As requested by a letter from the Ministry of Finance (dated 6 March 2014, No. 31-05110-14-8/4940 "On Realization of an Experiment on PPB Implementation at the Local Level in 2014"), information was gathered with regard to the status and results of PPB implementation at the local levels as of 1 January 2015. Based on these data, MFSI-II experts categorized and summarized the realization of the experiment in 2014. Among other things, the experiment participants have approved more than 36,000 budget programs, including 4,800 programs with indicators of budget savings. Their implementation resulted in more than UAH 1.1bn in savings.

The summarized information from the monitoring of the status and results of PPB implementation at the local level was submitted by IBSER for consideration of the Ministry of Finance of Ukraine.

See folder "Deliverables"

*Result/Deliverable: The MFSI-II Project website's column "Current Issues of PPB" and introduce a new column "Expert Answers on the Specific of Local Budgets Formation" maintained*

*Timeline: Continuously*

A new set of PPB-related questions (9 for the reporting period) with experts' answers has been placed on the site. In total, 209 answers to PPB-related questions have been prepared and posted on the website since the launch of the MFSI-II Project. They are regularly updated and relate to special circumstances of applying the Performance Program Budgeting methodology at the level of local budgets: providing clarifications with regard to the rules and procedures of filling out budget requests, compiling passports of budget programs, using the Codifier of Budget Programs, and conducting a comparative analysis of the performance efficiency of budget programs.

Also, appropriate preparatory activities have been conducted for introducing a new column "Expert Answers on the Specifics of Local Budgets Formation". Its test launch is scheduled for the next quarter.

See folder "Deliverables."

## **Task 1.2: Review the legislation and analyze the execution of the State and local budgets of Ukraine**

***Sub-task 1.2.1: Help local governments assess bills affecting their revenue and resource allocation including the State Budget Bill to identify and mitigate potential risks to local development***

To implement this task, MFSI-II will carry out:

- analyzed draft legislative amendments aimed targeting the revenue base of local governments;
- an analysis of the draft Budget Declaration for the next year prepared and suggestions regarding the document accepted and incorporated (annually);

- an analysis of the Budget Law for the respective year prepared and suggestions to it incorporated (annually);
- an analysis of amendments to the Budget Law for the respective year prepared and suggestions to it incorporated (if such changes are brought forward for consideration by the Verkhovna Rada);
- a completed analysis of amendments to the Tax Code, land and other laws related to local budgets, which could affect their revenues and resources.

*Deliverable: Analysis draft legislative amendments aimed targeting the revenue base of local governments*

*Timeline: Ongoing process*

*Deliverable: Analysis of the draft Budget Declaration for the next year prepared and suggestions regarding the document accepted and incorporated*

*Timeline: April – June 2015*

*Deliverable: Analysis of the Budget Law for the respective year prepared and suggestions to it incorporated*

*Timeline: December 2014*

On 31 December 2015, the President of Ukraine signed the Law of Ukraine “On State Budget of Ukraine for 2015” adopted by the Verkhovna Rada of Ukraine on 28 December 2014. The main parameters of the State Budget for the 2014-2015 are given in Table 1.

**Table 1**

**The main parameters of the State Budget for the 2014-2015**

UAH billion

	2014 revised plan	2014 executed as of 30.11.2014	Percent of execution	2015 plan	Deviations of 2015 plan from revised plan for 2014	
					+/-	%%
<b>REVENUES</b>	<b>382.3</b>	<b>319.1</b>	<b>83.5</b>	<b>475.9</b>	<b>93.6</b>	<b>24.5</b>
reverse (revenue-decreasing) subsidy (withdrawals in 2014)	2.2	1.9	86.4	3.6	1.4	65.6
<b>Total revenues (without interbudgetary transfers)</b>	<b>380.1</b>	<b>317.2</b>	<b>83.4</b>	<b>472.3</b>	<b>92.2</b>	<b>24.3</b>
<b>EXPENDITURES</b>	<b>467.9</b>	<b>378.3</b>	<b>80.9</b>	<b>527.9</b>	<b>60.0</b>	<b>12.8</b>
development expenditures	36.7	x	x	41.8	5.1	13.9
Pension Fund of Ukraine	81.7	69.5	85.1	80.9	-0.9	-1.1
intergovernmental transfers	136.8	117.1	85.6	163.6	26.8	19.6
<b>total expenditures (without interbudgetary transfers)</b>	<b>331.1</b>	<b>261.2</b>	<b>78.9</b>	<b>364.3</b>	<b>33.2</b>	<b>10.0</b>
<b>LENDING</b>	<b>5.1</b>	<b>3.0</b>	<b>59.0</b>	<b>11.7</b>	<b>6.6</b>	<b>129.8</b>
extension of loans	8.5	4.8	55.8	15.7	7.2	84.3
repayment of loans	3.4	1.8	51.2	4.0	0.6	16.9
<b>DEFICIT</b>	<b>68.6</b>	<b>62.3</b>	<b>90.8</b>	<b>63.7</b>	<b>-4.9</b>	<b>-7.1</b>
borrowing	290.9	261.2	89.8	293.8	2.9	1.0
repayment	109.1	90.9	83.2	158.9	49.7	45.6
proceeds from privatization of state-owned property	17.0	0.1	0.4	17.0		

The basis for calculation of the budget is the projected **nominal GDP** for 2015 in an amount of UAH 1,720.8 billion. Moreover, as stated in the Explanatory Note to the draft Law of Ukraine “On State Budget of Ukraine for 2015” (hereinafter – the “Explanatory Note”), this figure presents a conservative scenario, which is taken as a basis for the State Budget indicators. This figure is 12.9% higher than the expected figure for 2014<sup>1</sup>.

The growth rate of the above nominal GDP for 2015 is more than twice higher than the figure for the current year (12.9% versus 5.6%).

**The Consumer Price Index** is projected at 13.1%.

According to the Explanatory Note, revenues **of the consolidated budget** are defined in an amount of UAH 575.8 billion, that is UAH 101.7 billion, or 21.5% more than the amount of revenues approved for 2014 (as amended). Revenues **of the State Budget** are defined in an amount of UAH 475.9 billion, that is UAH 93.6 billion, or 24.5%, more than the amount of revenues approved for 2014<sup>2</sup>.

Such indicator as a share of GDP redistribution through the consolidated budget will be increased, respectively – from 28.7%<sup>3</sup> in 2014 to 33.5%<sup>4</sup> in the following year. The main explanation for this increase of fiscal pressure on the economy is a package of amendments to the Tax Code of Ukraine, which provides for substantial changes virtually to all components of the tax system.

**Expenditures of the State Budget** are defined in an amount of UAH 527.9 billion, that is UAH 86.3 billion, or 19.5%, more than the volume of expenditures approved for 2014 (as amended). Development expenditures were increased compared to the plan for 2014 by UAH 5.1 billion, or nearly 14.0%, compared to the previous year approved indicator. The expenditures of the Ministry of Health of Ukraine have increased significantly (by UAH 48.0 billion, or six fold), as well as those of the Ministry of Education and Science of Ukraine (by UAH 48.9 billion, or threefold). The above is due to the fact that according to the Law of Ukraine “On Amending the Budget Code of Ukraine” (concerning the reform of interbudgetary relations) No. 1557 dated 01 January 2015, new types of transfers were implemented, such as education and health government grants, grants for training labor, grants for healthcare activities under certain national programs and comprehensive activities that are programmatic in nature. Until now, the above expenditures used to be taken into account when calculating equalization grants funded through the Ministry of Finance of Ukraine.

Debt service expenditures increased by UAH 38.0 billion or twice as compared to the approved indicator for 2014. Expenditures of the Ministry of Defense of Ukraine increased by UAH 25.1 billion, or 2.6 times, the Ministry of Internal Affairs of Ukraine – by UAH 14.8 billion, or 1.8 times.

Compared to 2014, the shares of expenditures decreased as follows: social protection and social security by -3.0 pp., economic activity by -2.2 pp., education and general functions by -1.4 pp. and by -1.3 pp., respectively. The shares of expenditures on defense increased significantly to 8.4%, or by 3.0 pp., interbudgetary transfers to 31.0% or by 2.4 pp. The shares of expenditures on civil order, security and judiciary increased to 9.3% or 0.7 pp., on utilities to 0.2% or 0.1 pp.

**The deficit of the State Budget** is UAH 63.7 billion or 3.7% GDP (significantly lower than the planned 5.8% for 2014). This figure is by UAH 24.8 billion or 28.0% less than the planned deficit for 2014 (planned amount of the deficit for 2014 compared with 2013 is increased by UAH 23.8 billion, or 36.8%). At the same time, as in previous years, it is expected to allocate a portion of government domestic loan bonds (GDLB) (UAH 88.0 or 5.1% of GDP) to the purchase of securities of banks, the Deposit Guarantee Fund, “Naftogaz of Ukraine” (similar figure, planned for 2014, is UAH 111.9 billion or 7.3% GDP).

<sup>1</sup> This figure is slightly higher than that found in the consensus forecast made in September of the current year, which amounts to UAH 1.5169 bln. (<http://www.me.gov.ua/Documents/List?lang=uk-UA&tag=Konsensus-prognoz>)

<sup>2</sup> According to the data of the State Treasury of Ukraine (<http://treasury.gov.ua/main/uk/publish/article/241878>)

<sup>3</sup> This figure is calculated based on the annual plan decreased by the amount of budget non-execution promulgated by the State Treasury.

<sup>4</sup> According to data of the annual plan for 2014 (as amended)



Compared with the planned annual indicators for 2014, the expected amount of borrowings is expected to remain almost unchanged (with an increase of 1.0% only). The amount of debt repayment goes up significantly: by UAH 49.8 billion or 45.6%, which is explained by increased external debt payments, particularly due to the fall in the value of Hryvnia against the US dollar and Euro. The positive is that due to the above a gap between the amount of borrowings and debt repayment is decreased by 25.8% or to UAH 134.9 billion,

As in 2014, the deficit of the general fund budget in 2015 will exceed the planned development expenditures of the general fund budget. At the same time, such excess is significantly reduced, thus in 2015 it is planned to allocate 31.2% of the total amount of **borrowed funds and proceeds from privatization** to the general fund (UAH 15.5 billion) to consumption expenditures. Whereas in 2014 this figure was 61.7% (UAH 36.3 billion), and according to actual data for the first 9 months of 2014 it was 53.6%.

**Proceeds from privatization** are estimated at the level of the plan for 2014 – UAH 17.0 billion, which bears a budget risk. The above is due to the fact that actually UAH 0.1 billion was received for the 11 months of 2014 to the State Budget (in 2013 the plan for this figure was performed by 10.2%; in 2012 – 67.6%; in 2011 the plan was exceeded by 14.8% due to the sale of “Ukrtelecom” and in 2010 the performance level was 17.2%).

**The maximum (ceiling) public debt** was determined in an amount of UAH 1,176.1 billion, which is 68.3% of GDP, while the Budget Code sets out this ceiling at 60.0% of GDP<sup>5</sup>. According to the amendments to the Budget Code of Ukraine adopted on 28 December 2014, the Cabinet of Ministers of Ukraine should immediately apply to the Verkhovna Rada of Ukraine for permit a temporary excess of this threshold (ceiling) and submit an action plan for approval to adjust the total public debt and government-guaranteed debt in correspondence with the specified requirements.

In addition, Articles 16-18 gave the Cabinet of Ministers of Ukraine the right to issue domestic government bonds if necessary in excess of the amount established in Annex 2 to the Law, with subsequent acquisition in the state ownership, in exchange for bonds, shares of additional issues of banks, bills issued by the Deposit Guarantee Fund, and shares of additional issues of economic partnerships of the fuel and energy sector, whose 100% of shares are owned by the state, with a corresponding adjustment of the limit of public debt, as defined by the Law. The above will result in an even higher limit (ceiling) of debt and a greater debt burden on the budget in future years.

According to the recent amendments to the Budget Code of Ukraine (Law of Ukraine No. 79-VIII dated 28 December 2014 “On Amending the Budget Code of Ukraine with Regard to the Reform of Interbudgetary Relations”), **a new framework of local budgets equalization** was implemented, based on which the indicators of the State Budget for 2015 were approved.

The main difference in the new framework of equalization is cancelation (withdrawal) of equalization grants and introduction of the basic (reverse) grant and series of subventions for full current maintenance of all healthcare facilities belonging to the delegated powers and individual educational institutions<sup>6</sup>. Interbudgetary relations are laid down in the Law of Ukraine “On the State Budget of Ukraine for 2015,” including these amendments.

The total amount of **interbudgetary transfers**, provided from the State Budget to local budgets, compared with 2014 is increased by 30.9% and determined almost in an amount of UAH 163.6 billion. At the same time, capital subventions are reduced by 72.2% to UAH 0.9 billion.

The interbudgetary transfers largest by the amount that are provided from the State of Budget to local budgets become health and education grants: UAH 46.5 billion and UAH 43.7 billion, respectively. The Law of Ukraine “On the State Budget of Ukraine for 2015” approved allocation formulas for grants between local budgets and determined the amount of financing for all local budgets that have direct

<sup>5</sup> At that, the national debt limit (ceiling), which was formed at the end of November 2014, is accounted for almost a similar share of GDP expected for 2014.

<sup>6</sup> Education grants for maintenance of general secondary education schools and grant for labor training. Expense for pre-school and out-of-school education will be made out of own proceeds of local budgets and basic grants.

relationships with the State Budget. Analysis of these formulas shows that the approaches to allocating the corresponding expenditures to education and health, which were in force in 2014, have been taken as a basis<sup>7</sup>, when calculating equalization grants.

A basic grant is approved in an amount of UAH 5.3 billion. Its allocation is defined according to the indices of taxpaying capacity of the territories and approved amounts for all local budgets that have direct relationships with the State Budget. It is not intended for targeted use and can be used by local governments to finance any delegated powers.

When comparing the resource that is transferred from the State Budget to local budgets for funding delegated powers, a significant growth by 67.6% more than planned for 2014 is observed. In 2015 this resource is UAH 101.4 billion. The net transfer is increased by UAH 39.2 billion, or by 67.1%.

As a generalizing principal characteristic of the Law regarding the relationships of the State Budget with local budgets can be noted the transition to the new framework of equalization and significant social orientation of all transfers. At the same time, despite a significant increase in transfers, a disproportion in funding delegated authorities can arise and this will require revision of the budget indicators laid down by the results of budget execution in the first quarter of 2015.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

Result: Analysis of the amendments to the Budget Law for the respective year is prepared and the suggestions to it are incorporated in the Law (in case such changes are brought for consideration of the Verkhovna Rada of Ukraine)

Deliverable: Analysis of the changes to the Budget Law

Timeline: Depending on the date of law adoption

MFSI-II experts have analyzed the amendments to the Law on the State Budget of Ukraine for the Year 2015 approved by the Verkhovna Rada on 2 March 2015, No.217.

The amendments increase the State budget revenues by UAH 26.3bn to UAH 498.6bn or by 5.6%.

This increase is to be **achieved through tax revenues**. In particular, the value-added tax amount is increased by UAH 14.1bn, rent for subsoil use by UAH 9.6bn, enterprise profit tax by UAH 2.9bn, import duty by UAH 2.1bn, rent for gas and oil transportation by UAH 2.1bn etc.

Among other revenues, note should be made of an increased volume of international assistance (+UAH 1.3bn), in particular, that provided under European Union assistance programs (+UAH 1.1bn).

On the other hand, the amount of non-tax revenues is decreased with regard to the funds remitted by the National Bank of Ukraine pursuant to the Law of Ukraine "On the National Bank of Ukraine" by UAH 4.9bn, and the charge on non-cash foreign currency buying and selling transactions by UAH 1.9bn. According to an Explanatory Note to the Law of Ukraine "On Amending the Law of Ukraine 'On the State Budget of Ukraine for the year 2015'", these amendments have been made based on the results of negotiations with the International Monetary Fund mission.

According to the Explanatory Note to the Draft Law of Ukraine "On Amending the Law of Ukraine 'On the State Budget of Ukraine for the Year 2015'", **the main reason for revising the budget revenue target towards its increase** was the revision of the key macroeconomic indicators for 2015. Among other things, it deals with the increase of such indicators as nominal GDP by UAH 129.4bn up to UAH 1,850.2bn, Consumer Price Index, which more than doubled from 13.1% to 26.7%, and the official Dollar exchange rate against the Hryvnya, which rose from UAH 17 to UAH 21.7 or by 27.6%.

An average annual growth of State budget revenues never exceeded 10% in the last five years (including in the "crisis" years, when the role of inflation in budget execution growth). Therefore, their proposed increase by nearly 40% in the environment of declining industrial output and reduced consumption points to high risks of annual plan non-fulfillment, in particular with regard to tax revenues. Besides, this could create the preconditions for a hidden budget deficit, which would have to be liquidated

<sup>7</sup> Certain differences in the allocation are associated with considering some specific costs and adjusting factors.

either through a higher-than-planned inflation, or mid-year budget sequestration. The overstated revenue indicators would lead to heavier tax burden, including through accrual of overdue budget VAT refunds and increased amounts of tax overpaid for future periods.

**The expenditures of the State budget of Ukraine** are increased by UAH 39.5bn compared to the originally approved 2015 figure or by 7.4% to UAH 566.9bn. The development expenditures are increased by UAH 2.8bn or by 6.7%. Expenditures of the Ministry of Finance increased significantly (by UAH 29.6bn or 19.6%), including expenditures for State debt servicing by UAH 18.0bn or 24.1%. Also, growth of expenditures is observed, in particular, for the following key spending units:

- Ministry of Regional Development, Construction, and Housing and Communal Services by UAH 3.3bn or 2.7 times;
- State Motor Roads Agency by UAH 2.4bn or 11.4%;
- Ministry of Infrastructure by UAH 1.1bn or 35.3%;
- State Space Agency by UAH 0.9bn or 49.5%; and
- Ministry of Health by UAH 0.9bn or 1.5%, etc.

Expenditures of the Ministry of Social Policy suffered significant cuts (-UAH 0.8bn or 0.9%), namely, expenditures of the Pension Fund are reduced substantially (-UAH 3.9bn or by 1.1%), which is explained by taking the steps related to the present difficult situation.

**The State budget deficit** is increased up to UAH 75.8bn (by UAH 12.2bn or by 19.1%). This indicator amounts to 4.1% of GDP compared to 3.7% of GDP, as was originally approved. It is proposed to increase the gap between the borrowing and debt repayment amount by UAH 10.4bn or by 7.7% to UAH 145.3bn (this indicator will be UAH 56.3bn or 27.9% lower than in 2014).

It is proposed to increase the State budget borrowing by UAH 103.1bn or by 35.1%, and State debt repayment by UAH 92.7bn or 1.6 times. Raising of these indicators is mainly due to devaluation of the national currency.

The total amount of **inter-budget transfers** from the State budget to local budgets is increased by 9.3% against the originally approved figures at the outset of 2015 to UAH 178.9bn.

### Comparison of Key Indicators of Inter-Budget Transfers

UAH million

	2015 approved at year outset	2015 with amendments No.217 of 2 March 2015	Deviation of indicators approved at outset of 2015 and those due to amendments No.217 of 2 March 2015	
			+/-	%%
<b>Basic grant</b>	<b>5 358.0</b>	<b>5 358.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Additional grants</b>	<b>2 010.0</b>	<b>2 010.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Subventions total, including:</b>	<b>156 225.4</b>	<b>171 511.3</b>	<b>15 285.8</b>	<b>9.8</b>
General Fund subventions	155 423.7	167 809.5	12 385.8	8.0
Special Fund subventions	801.7	3 701.7	2 900.0	361.7
Social subventions	57 564.0	70 037.3	12 473.3	21.7
Capital subventions	848.8	1 641.8	793.0	93.4
Other subventions	97 812.6	99 832.2	2 019.5	2.1
<b>State budget transfers total</b>	<b>163 593.4</b>	<b>178 879.2</b>	<b>15 285.8</b>	<b>9.3</b>

The greatest changes in the structure of inter-budget transfers are linked to **more than doubling** of the State budget subventions to local budgets for granting benefits and housing subsidies to the

population to pay for electricity, natural gas, services of heat and water supply, and water removal, and rent (management and maintenance of buildings and structures and adjacent territories), removal of municipal solid waste and liquid waste (approved at UAH 11.9bn at the year outset and later increased to UAH 24.4bn).

*Thanks to these changes, the Government plans to ensure the provision of State support to the most vulnerable categories of citizens in paying for their housing and communal services, which according to the commitments before the International Monetary Fund should increase significantly (gas tariffs by 280% and heat by 66%). At the same time, without implementing a reform in the system of provision of housing subsidies to the population, these amounts might not be sufficient, and raising of tariffs will lead to increased defaults in payments for services used.*

In addition, **a subvention is approved for repaying the debt from the difference in tariffs for communal services**, which was approved by and/or agreed to by government authorities or local governments, at the amount of UAH 2.9bn. This subvention was approved without any allocation among the regions, which significantly increased the amount of unallocated transfers, which totaled UAH 7.1bn compared to UAH 4.6bn approved at the year outset.

**A subvention is reduced** for training of regular labor force by UAH 15.0mn. **The educational subvention** from the State budget to local budgets **is reduced** by UAH 236.3mn. According to the Explanatory Note, such modifications are linked to implementation of reform in education and the commitments before the International Monetary Fund. Among other things, it is envisaged that the following will be achieved:

- the enrolment will be reduced under State order for training of specialists, research and pedagogical professionals, and regular labor force, as well as enrolment for advanced courses and retraining of personnel (postgraduate education); and
- optimization will be conducted of the network of general educational institutions and vocational schools.

**The medical subvention** from the State budget to local budgets **is reduced** by UAH 375.8mn. Such changes are due to finalizing the subvention allocation formula and adjusting the calculation for the size of the population served by the healthcare institutions subordinated to the Ministry of Health and the Ministry of Infrastructure.

**Funding is cancelled of a subvention** from the State budget to local budgets for the projects of liquidation of the coal and peat industry enterprises and maintenance of safe operation of drainage complexes (the plan amounted to UAH 353.4mn). It is proposed to use these funds for increasing expenditures of the State budget program "Restructuring of the Coal and Peat Extractive Industry," which is implemented by the Ministry of Energy and Coal Industry of Ukraine.

**Instead of a State budget program** "The Renewal (Construction, Capital Repairs, Reconstruction) of Infrastructure in the Donetsk and Luhansk Oblasts" planned at the amount of UAH 300mn in the budget of the Ministry of Regional Development, Construction, and Housing and Communal Services, **a respective subvention is introduced** to local budgets of the Donetsk and Luhansk oblasts at the same amount.

To preserve the network of sports schools for children and youth, which used to receive support from the Temporary Disability Social Insurance Fund before 2015, **a new State budget subvention** to local budgets is envisaged for partial funding of such establishments at the amount of UAH 100.0mn.

In addition, **a number of new General Fund subventions of capital nature are introduced:**

- construction/acquisition of housing for families of the fallen military personnel who participated directly in the anti-terrorist operation, as well as for disabled persons of groups I-II from among the military servicemen who took part in said operation and require improved housing conditions (the plan amounts to UAH 300.0mn);
- procurement of new domestically-produced tram cars for municipal electric transport (UAH 100.0mn);
- completing the reconstruction of the Lviv Oblast Perinatal Center (UAH 45.0mn);
- co-financing of the project "Completion of Construction of the Metro System in the City of



Dnipropetrovsk" (UAH 29.0mn);

- construction of therapy building at the Odesa Oblast Children's Clinical Hospital (UAH 19.0mn).

**The right is granted** to the Cabinet of Ministers to allocate and reallocate the educational and medical subventions, and a subvention for training of regular labor force, so as to ensure servicing of the citizens displaced from the temporarily occupied territory of Ukraine and the areas of conduct of the anti-terrorist operation.

Also, the amendments **clarify and correct** the list of establishments, institutions, organizations, and activities in the departments of education, culture, healthcare, and physical culture and sport, which are transferred for financing/financial support by local budgets.

See folder "Deliverables"

*Deliverable: Analysis of the amendments to the Tax Code, land laws, and other laws related to local budgets, which could affect their revenues and resources prepared*

*Timeline: Depending on the date of law adoption*

On 28 December 2014 the Verkhovna Rada of Ukraine passed the Law of Ukraine "On Amending the Budget Code of Ukraine with Regard to the Reform of Interbudgetary Relations" No. 79-VIII. This Law incorporates the proposals of MFSI-II experts and in particular:

**1) The barriers to timely and full execution of debt service obligations by cities have been removed.** Now protected budget expenditures include local debt service costs. The above will allow the cities to make such expenditures in a timely fashion, guarantee the impossibility of its unjustified cuts during the budget period. These amendments will provide greater protection for creditors and increase their confidence in the borrowing cities, which will enhance their creditworthiness.

**2) Mayors of the cities of regional significance are delegated the powers to execute functions of a local financial authority.** This is connected with the fact that the financial authorities shall not be created in the cities of regional significance. Henceforth, the issue of such powers of a mayor of city of regional significance will be regulated at the legislation level as: depositing temporary free funds of local budgets or acquiring government securities; making the local borrowing; analyzing the budget request from the key spending unit and making a decision on its inclusion in the proposed draft local budget; forecast and analysis of the revenues of city budgets during its execution; approval of local budget implementation sheet and its execution under the budget implementation sheet.

**3) Transparency of budget execution is improved and efficiency and effectiveness of using the available budgetary resources is increased.**

The Law provides for strengthening the accountability of key spending units as related to formation of budget programs. In particular, the key spending units will be responsible for the timely approval of budget program IDs, the reliability and completeness of the information contained therein. Also the key spending units shall be responsible for introducing the forms of internal (management) accounts for gathering information required to confirm the performance indicators of budget programs. These changes will enable transition to budget planning of higher quality and improve the efficiency of the uses of budget funds.

The annual public presentation and publication of information on budget by budget programs and performance indicators have been regulated, as well as the publication of budget program IDs for the current budget period and statements of IDs execution for the reporting budget period. Such provisions would significantly improve the transparency of budget and provide an opportunity for public oversight of efficient use of budget resources.

In addition, the Law establishes that the performance program budgeting method in the budget process at the level of local budgets that have relationships with the State Budget shall be applied beginning from drafting local budgets for 2017. At the same time, this provision sets forth that PPB shall be applied to the

budgets of combined communities created under the law and perspective plan of forming the community areas. This is a new category of budgets that will be newly created and have their own characteristics, which are not included in the existing PPB methodology.

MFSI-II experts carried out also an analysis of all major amendments made to the Budget Code.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

On 28 December 2014, the Verkhovna Rada of Ukraine adopted Law of Ukraine “On Amendments to the Tax Code of Ukraine and Certain Legislative Acts of Ukraine on Tax Reform” No. 71-VIII. Accordingly, the main amendments to the tax laws are the following:

***Income tax:***

The amount of tax liability on income tax shall be determined by the financial result adjusted for the tax differences, which number is significantly reduced. Moreover, the full use of accounting (i.e., excluding tax differences) is provided for the taxpayers who have an income less than UAH 20 million per year. Accordingly, the regulatory authorities have the right to check the accuracy of record-keeping and determination of financial result in accordance with the appropriate standards.

In terms of the practice of tax law application, a norm that involves no penalties imposed by the results of audits of income tax returns for 2015 is quite liberal.

An income tax return, beginning from the tax returns for 2015 shall be submitted by June 1.

The tax rate, as before, is 18%. In the future, the system of making tax advance payments will operate.

***Value added tax:***

The changes with regard to VAT deal mainly with the procedural issues of its administration (including so-called electronic VAT administration).

In particular:

- the threshold for compulsory VAT registration increased from UAH 300 thousand to UAH 1 million;
- the deadline for inclusion of tax invoices to the tax credit is shortened up to 180 days;
- exports of grain crops are exempted from taxation;
- the tax exemption regime for the supply of waste and scrap of ferrous and non-ferrous metals is extended;
- VAT payers will have the right to declare a negative tax value to be refunded from the budget in the month of receipt of such negative value (not the following month, as previously).

The introduction of electronic VAT administration using a special account opened with the Treasury bodies and the calculation formula restricting the limit of tax invoices registration is postponed from 1 February to 1 July 2015.

The amendments also provide quite substantial penalties for violating the terms of registration of tax invoices with the Unified Register of Tax Invoices from 10 to 40% depending on the term of registration violation.

***Single tax:***

The number of single tax payers groups is decreased, the allocation criteria are changed and the tax rates are reduced.

Group I includes individuals who do not employ workers and only sell goods at market-places or provide household services to the population and have the income under UAH 300,000. The tax rate is up to 10% of the minimal wage.

Group II includes individuals having up to 10 employees and the income up to UAH 1.5 million. The tax rate is 20% of the minimum salary.

Group III includes individuals and legal entities with an income up to UAH 20 million. The tax rate is thus up to 2% of the income for VAT payers and 4% for non-payers.

Just like before, the single tax payers pay the unified social charge from their taxation basis as defined by the payers on their own, but no less than the amount of the minimal tax contribution.

Group IV includes the payers of fixed agricultural tax with similar taxation conditions.

***Personal income tax:***

The ceiling for the Personal income tax (with regard to the income, the total amount of which in a month exceeds the minimal salary amount under the laws of Ukraine (UAH 12180) is increased from 17 % to 20 %.

The separate rates will apply to the passive income regardless of the taxation base, in particular, 5% for income in the form of dividends on shares and corporate rights by resident taxpayers; 20% for all other types of passive income.

***Military duty:***

The military duty imposition shall be extended until the Resolution of the Verkhovna Rada of Ukraine on completion of the Armed Forces reform becomes valid and effective. The duty rate is not changed, however, the taxation base now includes the Personal income tax, while in 2014 it was limited to the salary and the payments under civil law contracts.

***Excise duty:***

The excise duty on securities sale is canceled. However, the products subject to excise now include electric power and heating by including into the excise a fee as a targeted surcharge to the current electricity and heating tariffs.

Moreover, a new excise is introduced on retail sales of alcohol drinks, tobacco products and fuel, which will act as a local tax for sales of several types of excise products (see below).

***Vehicle tax:***

In fact, a new tax was introduced in an amount of UAH 25,000 for the vehicles having the engine volume exceeding 3,000 cubic cm and manufactured less than 5 years ago.

The amendments to the Tax Code of Ukraine adopted on 28 December 2014 contain a number of innovations which will have an impact the financial capabilities of local budgets.

Both the list of local taxes and duties, and the approaches to administering them were changed. The real estate taxation basis was expanded by including non-residential premises. Moreover, a local sales tax was imposed as a retail excise duty for alcohol drinks, tobacco products and fuel. In addition to an obvious would-be budget revenues increase, these two new sources entail certain risks (adverse aspects).

***Tax on real estate other than the land plot:***

According to the IBSE experts, the introduction of the real estate tax shall be aimed to provide local self-government bodies with their own sustainable and adequate financial resources sufficient to carry out large (investment) projects.

The following conditions are necessary to efficiently introduce the real estate tax: taxation of all (!) real estate objects regardless of the legal conditions of use; solving the social issues related to the taxation of real estate owned (used) by the low-income people via the expenditure part of the budget; authorizing local self-government bodies to define the acceptable level of taxation on their own, that is, to establish rates within the range starting from zero and up to a quite high upper limit; accruing all the proceeds exclusively to local self-government budgets (that is, cities, villages and settlement); targeted use of the tax proceeds for the goals defined (approved) by the community; therefore, the tax proceeds shall be accumulated in the special fund of local self-governance budgets.

This approach shall ensure the following (advantages): the genuinely “local nature” of the real estate tax, sufficient financial resources for the local self-government; clear connection of paid funds to the obtained results ensuring the transparency of the budgetary process; engagement of all community members to the community activities by understanding the following chain: paid funds - obtained result; establishing taxation rates according to local peculiarities of the taxation objects and financial capacity of the people; increasing the responsibility of the elected local self-government managers; ensuring transparency of the budget funds expenditures; fair taxation through involvement of all community members into taxation.

The tax for real estate other than the land plot shall be paid at a rate of up to 2% of minimum salary per each square meter of the object space.

Despite the initial plans to include *all* residential and non-residential real estate objects into the

taxation base, the final language of the Law retains the reduction of the taxable space of each real estate object by 60 sq.m. for apartments and by 120 sq.m. for private houses. In addition, municipal, village and settlement councils may increase the tax-exempt limit of the real estate space determined by the Code. The law also provides for residential real estate tax exemptions of orphans, children deprived of parental care, disabled children being grown up by single mothers (fathers); non-residential premises such as minor architectural forms (MAFs), market premises, industrial buildings, including warehouses, as well as agricultural facilities.

Thus, the **provisions of Law have just maintained the existence of the unsustainable real estate taxation scheme** adopted in the initial Tax Code back in 2010 and never really operational in Ukraine: selected taxation of real estate with attempts to solve the problem of social protection for the low-income social strata via the revenue part of the budget. The IBSER experts have repeatedly emphasized that the real estate tax shall be chargeable from real estate objects rather than its owners. This system assures a fair and uniform approach to the taxation and minimizes the opportunities of tax avoidance. Moreover, this approach stipulates an easier, more transparent and foreseeable way to administer the tax: if there exists a real estate object, there should be tax proceeds from it. The approach stipulated by law entails determining (finding out) all real estate objects owned by the same person to properly determine the amount of tax to be charged; then, the shares of this amount due to different local budgets shall be determined if the real estate objects of the same owner are registered on different territories.

As for the residential real estate, the very principle of solving social problems through granting privileges to low-income populations is erroneous, as it does not guarantee that the privilege will be used only by the people who need help. Earmarked payments to the people in need of financial aid would be more efficient in terms of feasible use of financial resources. In other words, social problems must be solved at the expense of the expenditure part of budget rather than the revenue one.

The proposal to expand the real estate taxation base by including commercial real estate therein is highly disputable. Imposition of the commercial real estate tax would generate additional pressure, in the first place, on small businesses (hotels, restaurants and bars, tourist camps, shops, vehicle servicing stations, canteens, warehouses etc.), which goes contrary to the goal of stimulating consumption as a condition for overcoming the economic crisis.

Thus, the approved provisions of the Tax Code with regard to administering the tax on real estate other than the land plot retain the inefficient scheme of tax administration being unreasonably complicated in terms of administration, unfair in terms of even distribution of taxation and incapable in terms of finance. Thus, the existence of the real estate tax in this form is unfeasible.

***Excise duty from retail sales of alcoholic drinks, tobacco and fuel:***

The proposal to introduce a local excise for retail sales of beer, alcoholic drinks, tobacco products and fuel with the rate from 2% to 5% of their price including VAT is disputable. Actually, the proposal envisages a local sales tax for separate types of goods, and as the list includes only excise goods, the tax itself was called “excise.” However, by its nature – from the viewpoint of taxation base, calculation scheme and payers - this is not an excise but specifically a sales tax. Given the weak domestic market and the low paying capacity of population, the consumption will have affected both from the economic point of view (increased consumption is among conditions for a VAT increase) and from the point of view of higher volumes of illegal (smuggled and counterfeit) sales in excise goods.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

***Sub-task 1.2.2: Help the GOU develop and review budget legislation amendments that promote local-level strategic planning and enable local governments to attract private sector resources for local infrastructure projects. Help the GOU develop and review amendments to the Budget Code and bylaws that:***



- *Enable all creditworthy communities to access credit resources and fund their infrastructure projects;*
- *Regulate the process of adoption by local governments of responsibilities and financial obligations within PPP arrangements; and*
- *Enable local governments to separate energy efficiency savings from the rest of the budget and use them to reimburse implementers of performance contracts.*

Striving to assist cities in attracting resources of the private sector for implementation of infrastructure improvement projects, MFSI-II experts conducted three working meetings with the Public Private Partnership Development Program (P3DP) as part of the Memorandum of Cooperation signed by the Institute for Budgetary and Socio-Economic Research and P3DP on 2 October 2012. MFSI-II experts took part in a roundtable to discuss the Draft PPP Development Strategy in Ukraine for 2012-2017 and the Action Plan on 6 November 2012.

In order to remove the said barriers, MFSI-II experts have updated their proposals for amendments to the Budget Code of Ukraine. The prepared amendments to the Budget Code of Ukraine have been forwarded to all stakeholders for review.

If necessary, MFSI-II experts will prepare other drafts changes to the legislative and regulatory framework, will submit them for roundtables / meetings of NAB discussion, and will develop the strategy for promoting these changes.

*Result:* *Development of draft changes to the legislation and regulations*

*Deliverable:* *draft amendments to the Budget Code (if needed); draft decrees of the Cabinet of Ministers (if needed); draft decisions of the State Treasury (regarding the issues of budget execution when implementing PPP projects) (if needed)*

*Timeline:* *July – September 2015*

As noted above, **on 10 October 2014**, upon invitation from the USAID Public-Private Partnerships (PPP) Development Program and the American Chamber of Commerce in Ukraine, MFSI-II Project experts participated in a roundtable “Ukraine’s Health System Financing.” They also addressed issues that require improvements in the Ukrainian legislation as part of introduction of PPP (Budget Code, laws and bylaws), including:

- long-term budget obligations to be taken by a public partner based on PPP contracts, and fulfilled within the validity periods of such contracts;
- fair and real compensation to be paid by a public partner to a private partner for early termination of the PPP contract to reimburse the private partner for its reasonable loss (based on the termination causes).

MFSI-II Project experts will further cooperate with the PPP Development Program run by USAID in development of changes to the budgetary legislation for the purpose of introducing PPP in Ukraine.

*Accomplished* (see “Quarterly Report 01 October – 31 December, 2014”)

MFSI-II experts took part in working meetings and sessions of a Working Group on legislative regulation of application of such a component of public-private partnership as energy service contracts. The MFSI-II Project experts participated in the said meetings upon invitation from the Coordinating Center for Implementation of Economic Reforms under the President of Ukraine. This Working Group has been set up to address the issue of legal foundations for operation of energy service companies and implementation of energy service contracts. Representatives from the Ministry of Finance, Ministry of Economy, National Communal Services Regulatory Commission (National Commission), EBRD, and DTEK Company attended these meetings.

The Working Group considered, among other things, a Draft Law on amendments to the Budget Code of Ukraine. This Draft Law is needed to remove legislative barriers for introduction of energy service contracts. As a result, the meeting participants have supported inclusion into the legislative draft the proposals developed by the MFSI-II Project experts.

Within the fourth year of implementation, MFSI-II will take part in meetings and working groups on preparing other drafts changes to the legislative and regulatory framework of PPP implementation.

*Result/ Deliverable: Development of draft changes to the legislation and regulations (if needed)*

*Timeline: July – September 2015*

MFSI-II experts participated in six meetings arranged by various entities, including the State Agency for Energy Efficiency and Energy Conservation, in order to further elaborate law drafts on the possibility to engage private capital in energy-conservation activities in the public sector.

As a result, on 9 and 11 December 2014, similar legislative drafts were registered by MPs at the Verkhovna Rada of Ukraine. There are also amendments to the Budget Code identical to the legislative draft developed with Project participation.

The adoption of these amendments will make it possible for the first time to resolve problem issues preventing the introduction of energy service contracts at the legislative level. This will give a great boost to the energy independence of Ukrainian cities.

MFSI-II will participate in further work on the said legislative initiatives.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

On 5 February 2015, the Verkhovna Rada of Ukraine passed in the first reading a Draft Law of Ukraine "On Amending the Budget Code of Ukraine" (regarding introduction of new investment opportunities, guaranteeing the rights and lawful interests of economic entities in implementing large scale energy modernization), Reg. No. 1409 of 11 December 2014, which was developed with participation of MFSI-II Project experts.

This legislative draft creates the legislative foundations for attracting private investments for implementation of energy efficient projects in government-funded institutions. The MFSI-II experts have been participating in the development and coordination of the legislative draft for more than two years now. Adoption of this law will provide for:

- transparent arrangements in the conclusion and implementation of energy performance contracts;
- attractiveness of the public sector for potential investors in the energy saving sector by guaranteeing that their rights are protected;
- reducing the energy dependence of Ukrainian cities.

See folder “Deliverables.”

***Sub-task 1.2.3: Help local governments assess draft legislation affecting the local development and suggest amendments with a focus on strengthening local revenues***

The MFSI-II Project experts took part in a working meeting on 17 February 2012, chaired by Anatoliy Blyznyuk, the Minister of regional development, construction, and housing and communal services of Ukraine. Discussed at the meeting were the main directions and priorities of implementation of the local government and regional development reform. MFSI-II experts reviewed the provisions of the draft Law of Ukraine “On Associations of Territorial Communities” No.9590 of 14 December 2011 with regard to the financial support to associated communities. Conclusions and proposals were prepared and forwarded to all stakeholders in 22 February 2012. After this, the proposals were considered at the roundtable meeting at the Committee on State Building and Local Government of the Verkhovna Rada of Ukraine on

12 March, 2012.

MFSI-II experts have reviewed the following:

- the Decree of the Verkhovna Rada of Ukraine dated 7 February 2012, No.4350-VI directed to send for the repeated first reading the draft Law of Ukraine on the foundation of the State regional policy, which was registered by the Verkhovna Rada on 1 June 2010, under No.6462.
- the Cabinet of Ministers of Ukraine Decree of 21 March 2012, No. 312 "On Approving the Procedure of Using in 2012 the Assets of the State Regional Development Fund."
- the Cabinet of Ministers of Ukraine Decree of 4 July 2012, No. 656 "The Issues of the National Regional Development Fund"
- the Law of Ukraine "On the State Budget of Ukraine for the Year 2013" part of the formation of the Regional Development Fund.
- the Resolution of the Cabinet of Ministers of Ukraine of 23 January 2013 No. 30 which amended the Procedure for preparation, evaluation, and selection of the investment programs/projects, which can be implemented at the expense of resources of the State Regional Development Fund.
- the Cabinet of Ministers of Ukraine issued Ordinance of 20 March 2013 No. 149-r "Certain Issues of Utilization of State Capital Expenditures in 2013."
- the Decree of the Cabinet of Ministers of 14 August 2013 No. 576 amended the Procedure of using the resources of the State Regional Development Fund approved by Decree of the Cabinet of Ministers dated 4 July 2012, No.656 "The Issues of the State Regional Development Fund."

MFSI-II will review the draft legislation affecting local development and suggest amendments with a focus on strengthening local revenues (if an administrative and territorial reform is implemented, the said proposals will take the aspects of a new State Budget framework into consideration);

*Deliverable:* *The proposals based on the analysis findings prepared*

*Timeline:* *Ongoing process*

MFSI-II will review the legislative draft aimed at financial support of regional development, in particular, at establishment of a Regional Development Fund, and prepare its proposals intended for strengthening the financial resources of local governments.

*Deliverable:* *The proposals based on the analysis findings prepared (if changes are approved)*

*Timeline:* *April – June 2015*

### ***Sub-objective A.1: Ensure institutional sustainability of the training program(s) on the new budget legislation and PPB***

***Sub-task A.1.1: Study training centers that can offer training sessions on the new budget legislation and PPB, and methodological support to facilitate the introduction and effective application of PPB at the local level; identify those capable and interested in delivering training sessions on the new budget legislation and PPB, and providing methodological support on a regular basis***

According to the Project Work plan, MFSI-II had to start its selection of and collaboration with the Centers in 2012. In a timely manner, MFSI-II selected post-graduate educational institutions, which are capable of and interested in delivering PPB training sessions. Training centers were selected in the Kirovohrad, Odesa, Chernivtsi, and Zakarpatska oblast and in the city of Kyiv.

In collaboration with the Kirovohrad Center of Retraining and Qualifications Enhancement, MFSI-II

experts held a training on practical PPB implementation on 2 October 2013. On 10 October, a similar event was held at the Zakarpatska Regional Retraining and Qualifications Enhancement Center, the first training at this location. Participants included heads of budgetary organizations and institutions, and a training-of-trainers approach was used to build the capacity of local PPB specialists who would go on to train others.

These activities completed the first series of training for specialists of the selected training centers. The trainees were introduced to the theoretical foundations of PPB, instructive materials, and practical aspects of its application in accordance with the methodology documents developed by the Ukraine Ministry of Finance. This develops a practical expertise of delivering PPB trainings, which will subsequently enable local government staff to acquire the knowledge and skills required for effective PPB implementation.

According to the Memorandum of Cooperation with the Kyiv City Retraining and Qualifications Improvement Center, MFSI-II experts conducted an advanced training devoted to practical aspects of Performance Program Budgeting on 20 February 2014. The training participants were familiarized with changes in the PPB legislation, special conditions in the formulation of budget program passports, and implementation of a comparative analysis of budget program performance.

This event has launched a new series of training workshops for specialists of the selected training centers, who will be subsequently delivering PPB training sessions.

During the fourth year with MFSI-II support, these training center(s) will develop and approve a training curriculum and materials and deliver training sessions on the new budget legislation and PPB. Premises and all necessary equipment for training sessions on the new budget legislation and PPB will be provided by the entities to be selected.

*Deliverable: A report on the number of trainings for trainers and the number of trainees, with a breakdown by gender*

*Timeline: October 2014 – September 2015*

**8 trainings** on methodological aspects of Program Performance Budgeting (PPB) were carried out at the regional retraining and qualifications enhancement centers in Kirovohrad, Zakarpattia, Chernivtsi oblasts and the city of Kyiv. The public officials and local self-government bodies took part in them. The participants obtained were updated on PPB, specifics of budget program passports and benchmarking of the budget programs efficiency. 150 local-level specialists were trained, among them 23 men and 127 women.

These trainings followed up on the MFSI-II Project tasks on the institutional sustainability of PPB training programs. This practice would allow implementing the PPB methodology at the training centers providing continuous PPB training.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

MFSI-II experts conducted an advanced training devoted to methodological aspects of Performance Program Budgeting at the Kyiv City Retraining and Qualifications Improvement Center **on 20 February 2015**. The training participants were familiarized with changes in the PPB legislation, special conditions in the formulation of budget program passports, and implementation of a comparative analysis of budget program performance.

See folder “Deliverables”



***Sub-task A.1.2: Help the training centers to develop a training curriculum on the new budget legislation and PPB, and training materials and to conduct training sessions on the new budget legislation and PPB for relevant GOU officials***

MFSI-II will give over the handbook on specifics of local budgets formation to be developed under Sub-task 1.1.4 to the selected training centers, provide assistance in creation of the training curriculum and hold the trainings on the new budget legislation and PPB together with specialists from such training centers. This will allow officers of local governments to acquire knowledge and skills needed to bring into life the new legislation and implement PPB locally. Premises and all necessary equipment for training sessions on the new budget legislation and PPB will be provided by the entities to be selected.

On the whole, as part of collaboration with the Training Centers (*Sub-task A.1.1 and Sub-task A.1.2*), 1383 local specialists were trained, including 1210 women and 173 men.

*Deliverable: A report on the number of trainings for trainers and the number of trainees, with a breakdown by gender*

*Timeline: January – September 2015*

**On 10-11 February, 17 February, and 23-25 February 2015**, the staff of the Kirovohrad Regional Retraining and Qualifications Improvement Center conducted scheduled PPB trainings. The trainings were attended by public servants, heads of Finance Directorates of raion State administrations, and local government officials.

The trainings continued implementation of the MFSI-II Project task of assuring institutional sustainability of PPB training programs. Such practices will help introduce PPB methodologies based at the training centers, which will provide an ongoing PPB training.

On the whole, as part of collaboration with the Training Centers (*Sub-task A.1.1 and Sub-task A.1.2*), 113 local specialists were trained in the reporting quarter, including 92 women and 21 men. Since the outset of Year four of the MFSI-II Project, 263 local specialists, including 219 women and 44 men passed through this training.

See folder “Deliverables”

***Objective 2: Develop and introduce financial practices that foster energy efficiency in 15 selected cities***

**Task 2.1: Assist the cities in introducing an efficient framework for managing energy savings in the public sector**

- MFSI-II will improve the unified methodology developed during the first year of project implementation and will select four Ukrainian cities for the fourth year of the project. MFSI-II will coordinate selection with Public Private Partnership Development Program and Developing Initiative for Advocating Local Governance in Ukraine (DIALOGUE).
- To assist the cities in developing well-founded energy efficiency programs, MFSI-II will develop a system of monitoring of energy expenditures based on PPB method for the selected four cities, which will be based on similar system developed for the cities selected for the first year of the project. In order to implement this system and based on the experience of MFSI-II Project accumulated in the

first year of implementation, MFSI-II will prepare the training materials on implementation of the said system and will conduct training for specialists of key spending units in four selected cities.

*Result/Deliverable: Four Ukrainian cities for the fourth year of the project are selected using the developed unified methodology*

*Timeline: October – December 2014*

For participation in the fourth year of the MFSI-II Project, the cities were selected in line with the updated selection methodology developed in the first year of the Project.

The competition results showed a success for the cities of Sumy, Komsomolsk, Chernivtsi, Artemivsk, Kirovohrad and Berdychiv, and the Memoranda of Cooperation were made with them.

The agenda of energy efficiency and energy saving is duly reflected in the policies of the selected cities' councils. For instance:

- An energy saving and energy efficiency program in the budgeting sphere of Sumy city for 2014-2016;
- An energy sustainability plan of Komsomolsk city for the period up to 2025, an action plan on sustainable energy development of Kirovohrad up to 2020.

The cities must not only strive to improve their energy efficiency as a whole, but should also undertake practical energy saving activities/projects. Therefore, existence of the latter was one of the criteria in the city selection. All the chosen cities meet it, for example:

- The project "Streamlining the Heating Lay-out with Installing a Modular Thermal Generator at 88-a Kotovskoho Str." (Berdychiv);
- The project "Overhauling the Street Lighting through Upgrading Lighting Devices with LED-lamps" (Chernivtsi), etc.

Collaboration of the cities with the MFSI-II Project will help the cities to improve their energy efficiency, will facilitate establishment of an effective energy saving system in each of the selected cities, in particular, through experts' development of a system for monitoring of energy expenditures for the cities, and financial incentives for energy saving in the budgetary sphere. The participation of city representatives in the seminars, working meetings, and other events organized by the MFSI-II Project will create opportunities for experience-sharing and for learning from the best domestic and international practices of improving the energy efficiency at the local level.

Accomplished (see "Quarterly Report 01 October – 31 December, 2014")

*Result: Analysis of four selected cities on current budget expenditures on energy resources.*

*Deliverable: Report on analysis of four selected cities on current budget expenditures on energy resources.*

*Timeline: January – March 2015*

MFSI-II experts have analyzed the energy expenditures of six selected cities (Sumy, Komsomolsk (Poltava region), Chernivtsi, Artemivsk, Kirovohrad and Berdychiv) in 2011-2014.

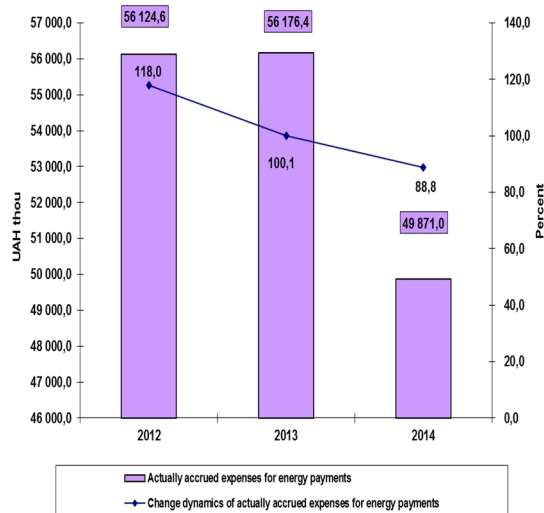
The analyzed data indicated that heating (KEKV 2271), water supply and water removal (KEKV 2272), electric power (KEKV 2273), and natural gas (KEKV 2274) decreased for all analyzed cities in 2014 compared to 2012. The most significant reduction of expenditures in 2014 was observed in the city of Sumy (UAH 6 million). The expenditures decreased by UAH 4.3mn in 2014 compared to 2012 in Chernivtsi, by UAH 3.1mn in Artemivsk, by UAH 2.0mn in Komsomolsk, Poltava oblast, by UAH 1.0mn in Kirovohrad, and by UAH 0.7mn in Berdychiv.

**Chart 1**

**Rate of Growth of Utility and Energy Expenditures  
in Sumy in 2012-2014**

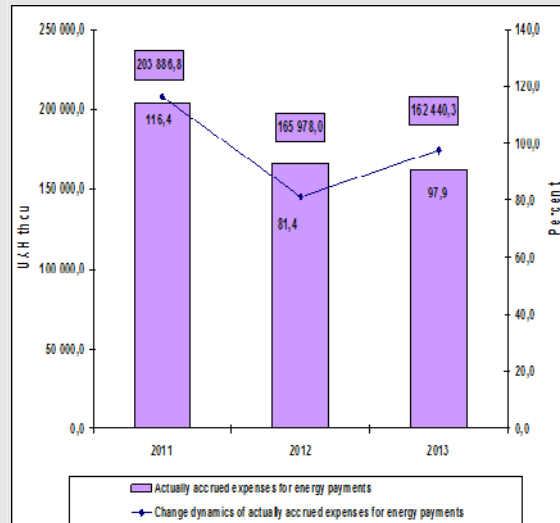
**Chart 2**

**Rate of Growth of Utility and Energy Expenditures in  
Chernivtsi in 2012-2014**



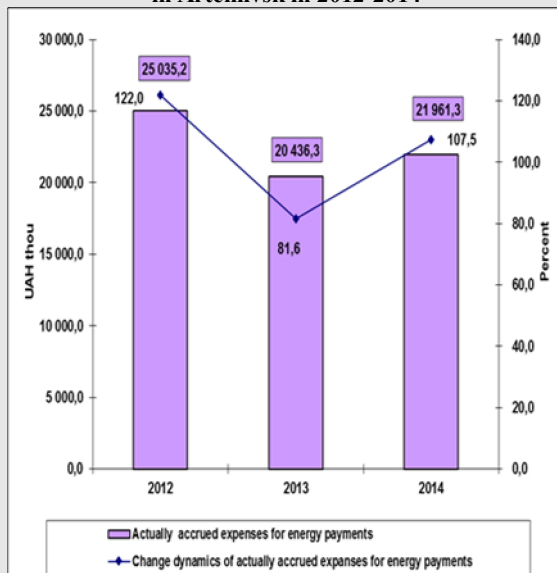
**Chart 3**

**Rate of Growth of Utility and Energy Expenditures  
in Artemivsk in 2012-2014**



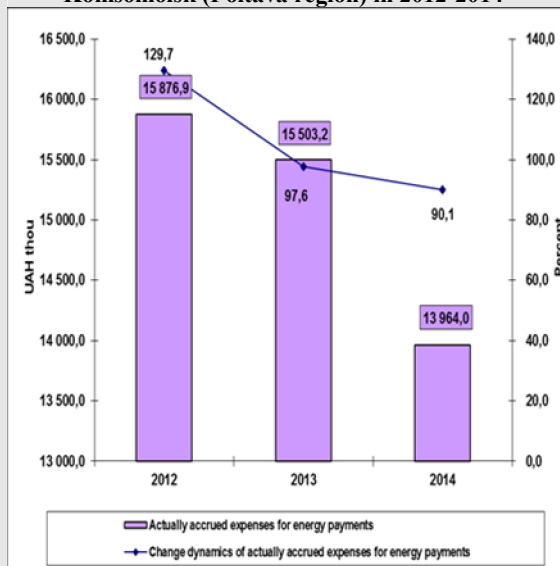
**Chart 4**

**Rate of Growth of Utility and Energy Expenditures in  
Komsomolsk (Poltava region) in 2012-2014**



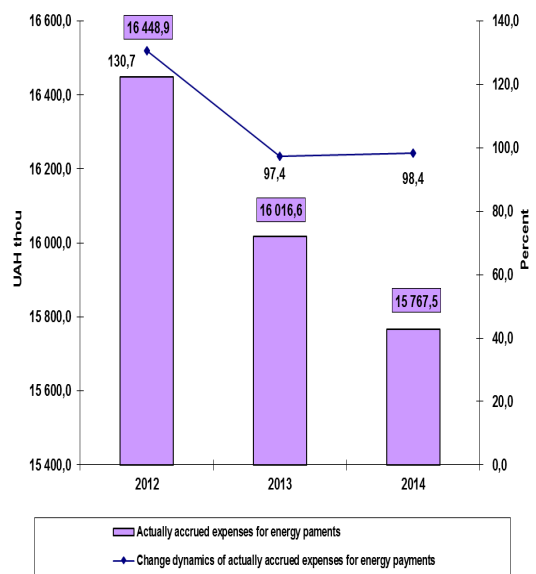
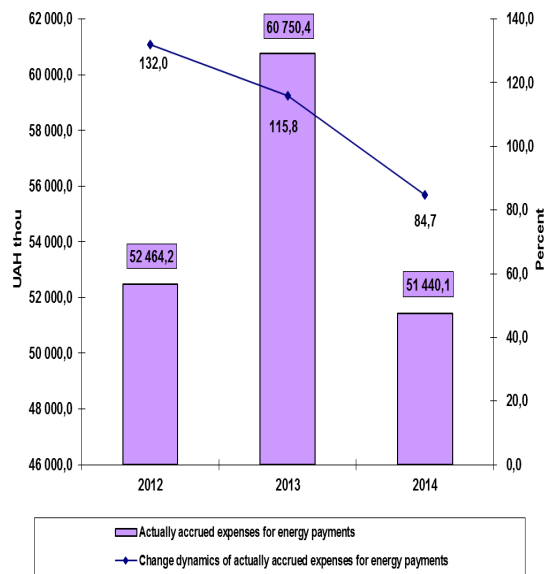
**Chart 5**

**Rate of Growth of Utility and Energy Expenditures  
in Kirovohrad in 2012-2014**



**Chart 6**

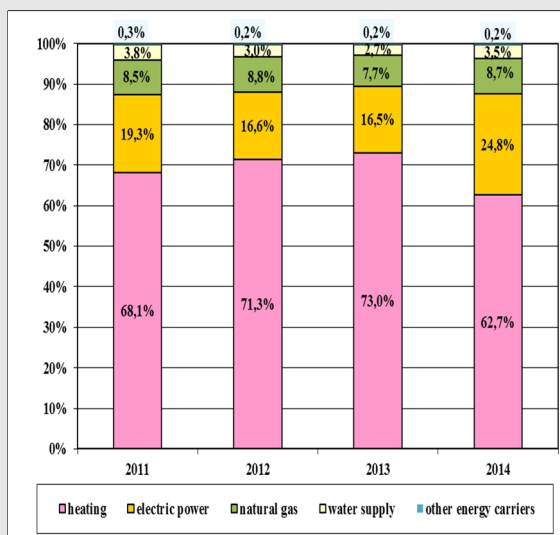
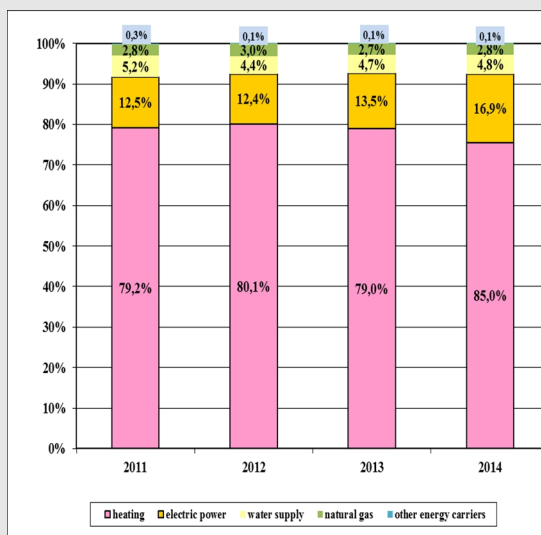
**Rate of Growth of Utility and Energy Expenditures in  
Berdychiv in 2012-2014**



Heating has the largest proportion in the overall structure of energy expenditures of the six cities (83.1% on average for the cities in 2014). Electric power is the second largest group of expenditures, with an average percentage of 13.0% in the total structure of all selected cities in the last four years (see Chart 7).

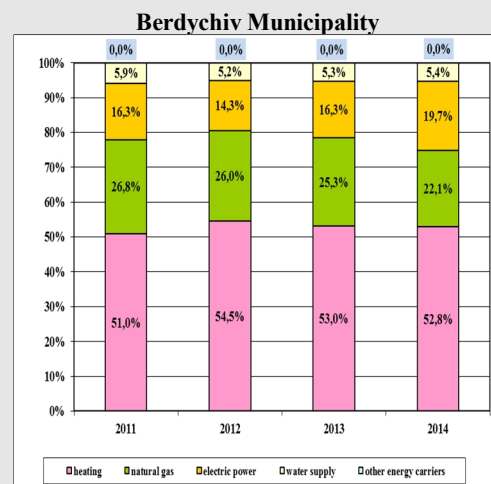
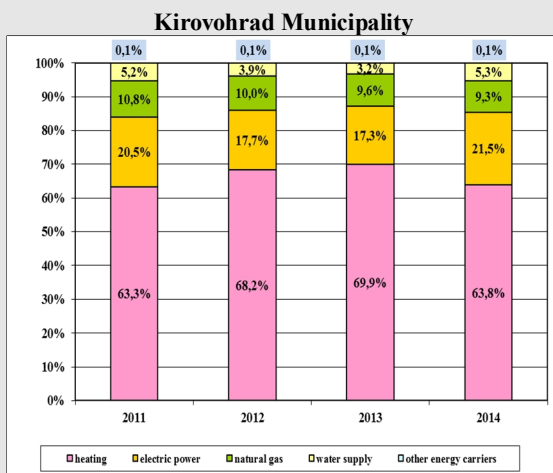
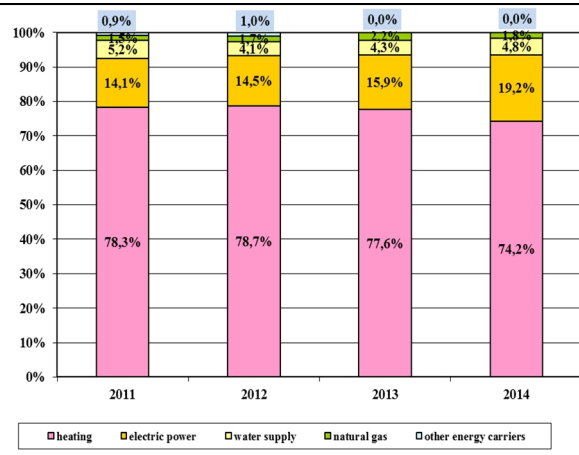
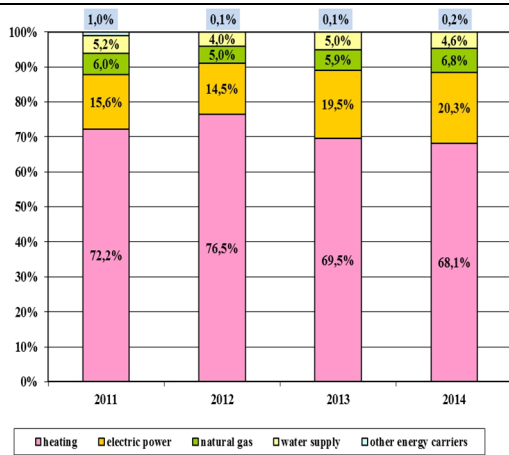
**Chart 7**

**Structure of Energy Expenditures by Sector in 2011-2014**  
 Sumy Municipality      Chernivtsi Municipality

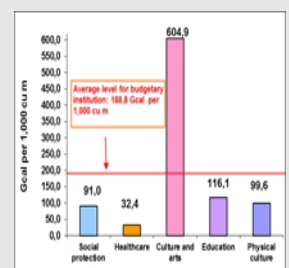


**Artemivsk Municipality**

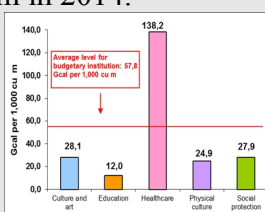
**Komsomolsk (Poltava region) Municipality**



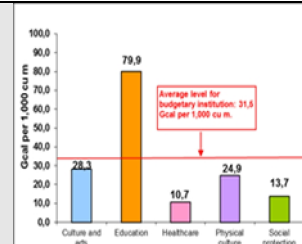
Widely differing amounts of heat consumption per 1,000 cu m of heated space were observed in 2014: The highest amounts were used by budgetary institutions in **Sumy** in 2014 (based on the average indicator value for all sectors, which amounted to, 188.8 Gcal per 1,000 cu m).



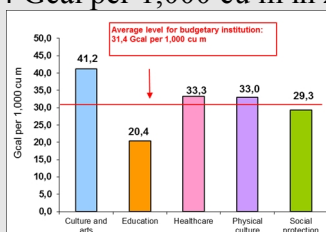
The average indicator for all budgetary institutions of **Kirovohrad** amounted to 57.8 Gcal per 1,000 cu m in 2014.



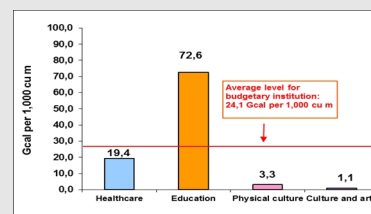
The **Berdychiv** city showed the heat consumption level of 31.5 Gcal per 1,000 cu m of heated space.



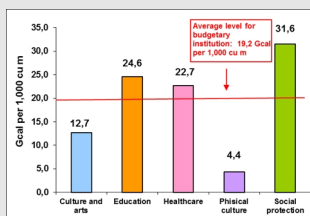
The average indicator for all budgetary institutions of **Komsomolsk (Poltava region)** amounted to 31.4 Gcal per 1,000 cu m in 2014.



The average indicator for all budgetary institutions of **Chernivtsi** amounted to 24.1 Gcal per 1,000 cu m in 2014.



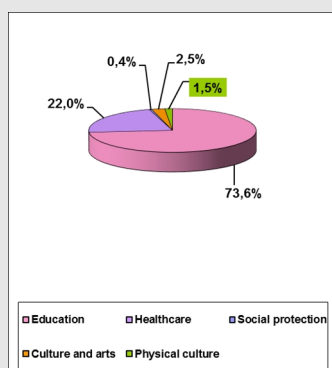
**Artemivsk** shows the lowest heat consumption level with 19.2 Gcal per 1,000 cu m of heated space.



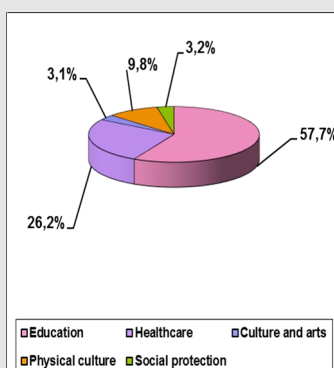
Based on the conducted analysis of municipal budget expenditures for energy, the following was found:

**Chart 8**

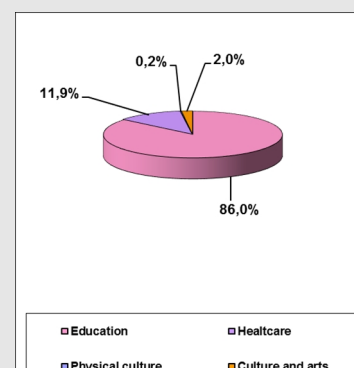
**Structure of Heat Consumption by Sumy Budgetary Institutions in 2014**



**Structure of Heat Consumption by Komsomolsk (Poltava region) Budgetary Institutions in 2014**



**Structure of Heat Consumption by Chernivtsi Budgetary Institutions in 2014**

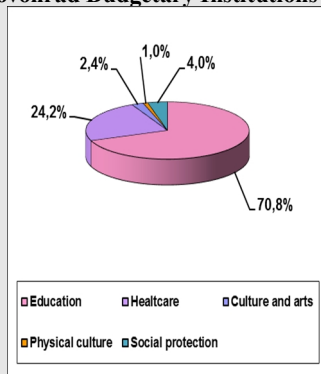


The highest amounts of heat consumption per 1000m<sup>3</sup> by Sumy are used by government-funded institutions in the department of culture and arts at 604.9Gcal per 1000m<sup>3</sup>. The volume of heat consumption per 1000m<sup>3</sup> for the departments of education and physical culture amounted to 116.1Gcal per 1000m<sup>3</sup> and 99.6Gcal per 1000<sup>3</sup>, respectively. The social protection sector uses 91.0Gcal of heat per 1000m<sup>3</sup>. Government-funded institutions in healthcare use 32.4Gcal per 1000m<sup>3</sup>.

The highest proportion of heat consumption per 1000m<sup>3</sup> by Komsomolsk (Poltava region) is noted for government-funded institutions in the departments of education (57.7% in 2014 or 2.9ppt more than in 2013) and healthcare (26.2% or 0.6ppt less than in 2013). The consumption share of physical culture institutions varied from 11.3% in 2013 to 9.8% in 2014. The government-funded institutions in the field of social protection account for 3.2%, which is 0.8ppt less than in 2013. The share of consumption for the department of culture and arts was unchanged at 3.1% in 2014.

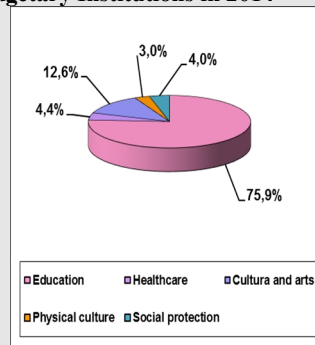
The largest shares in Chernivtsi fall on the government-funded institutions in the departments of education (86.0% in 2014 or 0.8ppt more than in 2013) and healthcare (11.9% or 0.7ppt less than in 2013). In the field of culture and arts, the share of consumption remained unchanged at 2.0% in 2014. The budgetary institutions in the field of culture and arts account for 2.4%, which is 0.5ppt less than in 2013. The share of consumption in the department of physical culture amounted to 0.2% in 2014, which is the same as in 2013.

**Structure of Heat Consumption by Kirovohrad Budgetary Institutions in 2014**



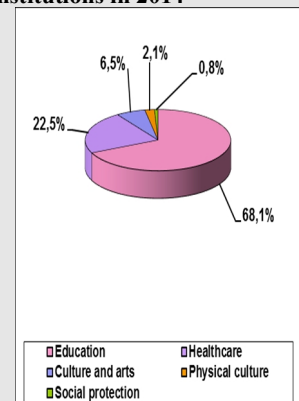
The highest volumes of heat consumption per 1000m<sup>3</sup> by Kirovohrad are used by the government-funded institutions in the departments of education (70.8% in 2014 or 1.5ppt less than in 2013) and culture and arts (24.2% or 1.8ppt more than in 2013). In the field of social protection, the share of consumption varied from 2.4% in

**Structure of Heat Consumption by Berdychiv Budgetary Institutions in 2014**



The highest volumes of heat consumption per 1000m<sup>3</sup> by Berdychiv were observed for the government-funded institutions in the departments of education (57.7% in 2014 or 2.9ppt more than in 2013) and healthcare (26.2% or 0.6ppt less than in 2013).

**Structure of Heat Consumption by Artemivsk Budgetary Institutions in 2014**



The largest shares fall in Artemivsk on the government-funded institutions in the departments of education (68.1% in 2014 or 0.7ppt less than in 2013) and healthcare (22.5% or 1.3ppt more than in 2013). In the field of culture and arts, the share of consumption amounted to 6.5% in 2014, which is 0.6ppt less than in 2013. The government-funded institutions of physical culture account for 2.1%, which is 0.1ppt less than in



2013 to 4.0% in 2014. The government-funded institutions in the field of culture and art account for 2.4%, which is 0.5ppt more than in 2013. The share of consumption in the department of physical culture remained unchanged in 2014 and amounted to 1.0%.

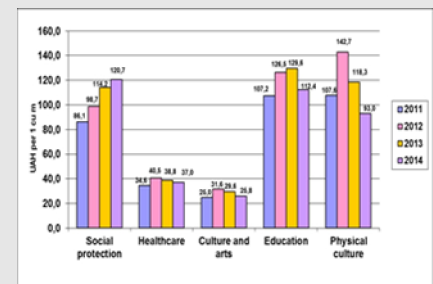
In the department of physical culture, the share of consumption varied from 11.3% in 2013 to 9.8% in 2014. The government-funded institutions of social protection account for 3.2%, which is 0.8ppt less than in 2013. The share of consumption in the department of culture and art remained unchanged in 2014 and amounted to 3.1%.

2013. The share of consumption in the department of social protection changed insignificantly (up 0.1ppt) in 2014 and amounted to 0.8%.

The amounts of funds spent by budgetary institutions for energy per 1 cu m of heated space differed significantly in the selected cities and were as follows in 2011-2014:

### Sumy

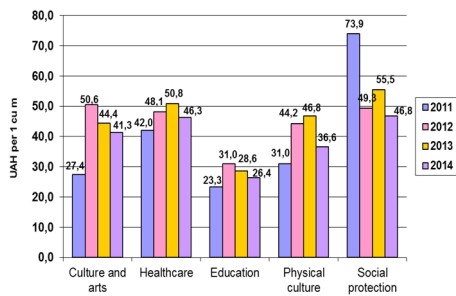
In 2014, the greatest amount of such funds was used by institutions in the department of social protection, where it amounted to UAH 120.7 per 1m<sup>3</sup> in 2014, with UAH 112.4 per 1m<sup>3</sup> in the education department, UAH 93.0 per 1m<sup>3</sup> in the department of physical culture, and UAH 37.0 per 1m<sup>3</sup> in healthcare department. This indicator was the lowest for the institutions in the department of culture and arts at UAH 25.8 per 1m<sup>3</sup> in 2014.



### Komsomolsk (Poltava region)

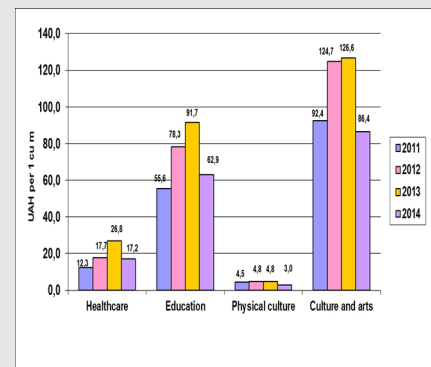
The largest amount of such funds in 2014 was spent by institutions in the department of social protection, where it equaled UAH 46.8 per 1m<sup>3</sup>, with UAH 46.3 per 1m<sup>3</sup> in the department of healthcare, UAH 41.3 per 1m<sup>3</sup> in the department of culture and art, and UAH 36.6 per 1m<sup>3</sup> in the department of physical culture. The government-funded institutions in the department of education had the lowest such indicator of UAH 26.4 per 1m<sup>3</sup> in 2014.





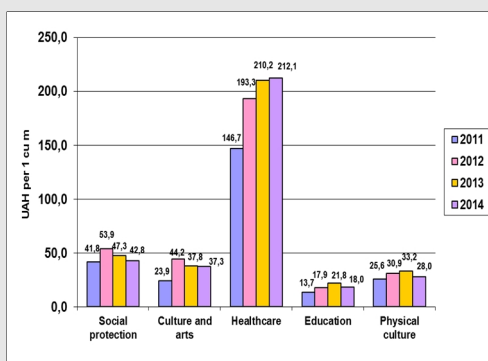
### **Chernivtsi**

The largest amount of such funds was spent in 2014 by institutions in the department of culture and art, where it equaled UAH 86.4 per 1m<sup>3</sup> in 2014, with UAH 62.9 per 1m<sup>3</sup> in the department of education, and UAH 17.2 per 1m<sup>3</sup> in the department of healthcare. The government-funded institutions in the department of physical culture had the lowest such indicator, which amounted to UAH 3.0 per 1m<sup>3</sup> in 2014.



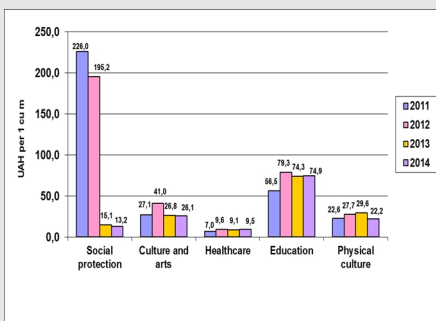
### **Kirovohrad**

In 2014, the largest amount of such funds was spend by institutions in the department of healthcare, where it equaled UAH 212.1 per 1m<sup>3</sup> in 2014, with UAH 42.8 in the department of social protection, UAH 37.3 per 1m<sup>3</sup> in the department of culture and arts, and UAH 28.0 per 1m<sup>3</sup> in the department of physical culture. This indicator was the lowest for government-funded institutions in the department of education at UAH 18.0 per 1m<sup>3</sup> in 2014.



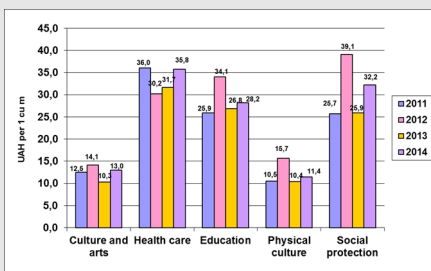
### **Berdychiv**

The largest amount of such funds in 2014 was spent by institutions in the department of social protection, where it amounted to UAH 46.8 per 1m<sup>3</sup>, with UAH 46.3 per 1m<sup>3</sup> in the department of healthcare, UAH 41.3 per 1m<sup>3</sup> in the department of culture and arts, and UAH 36.6 per 1m<sup>3</sup> in the department of physical culture. This indicator was the lowest in the government-funded institutions of the education department at UAH 26.4 per 1m<sup>3</sup> in 2014.



### Artemivsk

The largest amount of such funds in 2014 was spent by institutions in the healthcare department, where it equaled UAH 35.8 per 1m<sup>3</sup> in 2014, with UAH 32.2 per 1m<sup>3</sup> in the department of social protection, UAH 28.2 per 1m<sup>3</sup> in the department of education, and UAH 13.0 per 1m<sup>3</sup> in the department of culture and arts. This indicator was the lowest for the government-funded institutions in the department of physical culture, where it amounted to UAH 11.4 per 1m<sup>3</sup> in 2014.



Based on the analysis findings, the MFSI-II experts have developed recommendations for the Project cities (Sumy, Komsomolsk (Poltava region), Chernivtsi, Artemivsk, Kirovohrad and Berdychiv):

1. Track the energy performance and condition of buildings when finalizing the system of monitoring and evaluation of energy expenditures of each city.
2. It is advisable to investigate the reasons behind high levels of heat consumption per 1,000 cu m of heated space in some cities, and examine the factors, which have contributed to lowering these levels in others.
3. It is advisable to apply certain standards for ratios of heated space to the number of persons served by institutions (or to the number of staff for the institutions, which provide government services), which, in turn, would allow to analyze the efficiency of using the space occupied by budgetary institutions.
4. When improving the system of monitoring and evaluation, make sure to document the justification of the interrelation between the decrease / increase in consumption of utilities and energy and the energy saving activities, deterioration of the state of buildings, weather conditions etc.

See folder “Deliverables”

*Result/Deliverable: Update the system for monitoring energy-related budget expenditures for four selected cities.*

*Timeline: April – June 2015*

*Result/Deliverable: The training course developed and a report prepared on the number of trainings held and the number of specialists who participated in trainings with a breakdown by sex.*

*Timeline: July – September 2015*

**Task 2.2: Assist in designing and implementing financial incentives to promote the establishment of an efficient energy savings framework in the public sector**

- MFSI-II experts will help municipalities design and introduce financial incentives to promote the establishment of effective energy savings system in the public sector.
- If needed, a review and improvement of the budget legislation needed for implementation of the said financial incentives will be carried out under Task 1.2.3.
- To help the chosen municipalities introduce the financial incentives that foster energy efficiency, MFSI-II will provide advisory support to the municipalities in designing budget programs, in particular, those intended for the realization of individual investment projects.
- If, given the environment of limited budget resources, the cities will be unable to implement the system of financial incentives, MFSI-II will suggest other mechanisms for ensuring energy efficiency in the public sector, e.g., establishment of Energy Saving Fund. MFSI-II will propose the sources for accumulation of such Fund, spending areas, principles for selecting priority projects etc.
- If legislative amendments are approved, in particular those to the Budget Code with regard to implementation of energy service contracts in the public sector, MFSI-II will develop the training materials on this topic and deliver training/provide consultations to the selected cities and other interested cities in Ukraine.

*Deliverable: Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector are updated and presented at a session of the Financial and Economic Forum.*

*Timeline: October 2014 – March 2015*

As indicated in Sub-task 1.2.3, on 9 and 11 December 2014, similar legislative drafts with regard to the possibility of engaging private capital into energy-saving activities in the public sector were registered by MPs at the Verkhovna Rada of Ukraine. There are also amendments to the Budget Code identical to the legislative draft developed with involvement of the Project. The draft laws also stipulate financial incentives to promote the establishment of an effective energy savings system in the public sector, in particular, due to enabled retaining in the budget a part of savings coming from energy-efficiency activities even before completing the settlements with a private partner under them.

The MFSI-II experts will take part in drafting by-laws in order to implement the said legislative norms (after its approval), while the practical recommendations on this implementation will be presented at a session of the Financial and Economic Forum.

**Accomplished** (see “Quarterly Report 01 October – 31 December, 2014”)

As indicated in Sub-task 1.2.2, on 5 February 2015, the Verkhovna Rada of Ukraine passed in the first reading a Draft Law of Ukraine "On Amending the Budget Code of Ukraine" (regarding introduction of new investment opportunities, guaranteeing the rights and lawful interests of economic entities in implementing large scale energy modernization). The draft law also stipulate financial incentives to promote the establishment of an effective energy savings system in the public sector, in particular, due to enabled retaining in the budget a part of savings coming from energy-efficiency activities even before completing the settlements with a private partner under them.

The MFSI-II experts will take part in drafting by-laws in order to implement the said legislative norms (after its approval), while the practical recommendations on this implementation will be presented at a session of the Financial and Economic Forum.

*Deliverable: Consultations on system implementation provided to the cities, including for development of budget programs and individual investment projects (or with regard to other mechanisms of ensuring energy efficiency in the public sector).*

*Timeline: October 2014 – September 2015*

With the advisory support provided by the MFSI-II Project, the city of Sievierodonetsk got approval from the Ministry of Finance of Ukraine for the scope and terms of granting a local guarantee for implementation of the Sievierodonetsk Street Lighting project.

The main goal of the project is to reduce energy consumption, improve efficiency of energy utilization, and install a more efficient new equipment. Thus, the electric power consumption will be reduced thanks to replacement of the existing street lights with new energy-efficient LED lights providing the energy economy of 322.2MW per year. Implementation of the project will have a significant environmental impact, in particular, by reducing the CO<sub>2</sub> emissions by 258 tons per year.

The successful completion of the Sievierodonetsk Street Lighting project will have an important socioeconomic effect, as it will ensure improved safety of motor and pedestrian traffic.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

MFSI-II experts are providing systematic consultations to the Project cities on implementation of a system of financial stimulation for efficient use of energy resources by budgetary institutions, including the development of budget programs and individual investment projects. Also MFSI-II suggested to address certain additional issues for each local council. Therefore, MFSI-II experts are providing advisory support for receiving loans approval by the Ministry of Finance of Ukraine for financing the investment projects of selected cities Berdychiv and Slavutych.

*Deliverable: Training /consultations to selected cities and other interested Ukrainian cities with regard to implementation of energy service contracts in the public sector (if appropriate amendments to the legislation, in particular to the Budget code, are approved).*

*Timeline: January – September 2015*

As indicated in Sub-task 1.2.2, on 5 February 2015, the Verkhovna Rada of Ukraine passed in the first reading a Draft Law of Ukraine "On Amending the Budget Code of Ukraine" (regarding introduction of new investment opportunities, guaranteeing the rights and lawful interests of economic entities in implementing large scale energy modernization).

After the approval of said legislative amendments in general and the necessary bylaws, MFSI-II experts will train/consult selected cities and other interested Ukrainian cities with regard to implementation of energy service contracts in the public sector.

### **Task 2.3: Assist partner municipalities in building the capacity of municipal enterprises to conduct modern financial analysis and planning to support their strategic and annual plans**

The MFSI-II experts will assist the partner cities in strengthening the capacity of communal service enterprises to carry out a financial and economic analysis and planning as part of their strategic plans and action plans, including their coordination and matching with the municipality's strategic goals and objectives.

*Deliverable: Report prepared on the number of trainings on the monitoring and evaluation of energy efficiency projects implemented by municipal enterprises and implementing of the methodology of financial and economic justification of strategic and planning documents of municipal enterprises*

*consistent with the municipality's strategic goals held and the number of specialists who participated in trainings with a breakdown by sex*

*Timeline:* January – March 2015

On 27 March 2015, MFSI-II experts provided support in delivering a seminar Planning and Evaluation Efficiency, Including That for Energy Performance Projects, as the Guarantee of Achievement of Strategic Objectives.

The event was attended by representatives of municipal utilities and executive committees of city councils of Project partner cities, namely: Kyiv, Kryvyi Rih, Komsomolsk (Poltava Oblast), Slavutych, Chernivtsi, Sumy, Berdychiv, and Kirovohrad (total of 23 participants, including 6 women and 17 men).

In the course of the seminar, the participants received recommendations for improving the effectiveness of financial justification of strategic documents by municipal utilities in the context of city development priorities, and were introduced to a methodology for monitoring and evaluating energy efficiency projects.

In addition, representatives from Slavutych, Berdychiv, Chernivtsi, Kirovohrad, and Komsomolsk delivered presentations on the experience of their cities and municipal utilities in attracting investments and implementing energy saving projects.

Using the knowledge acquired during the seminar will make it possible for the municipal utilities to apply state-of-the-art approaches in developing their strategic and planning documents, carry out effective monitoring and evaluation of individual energy saving projects.

Also, the above will contribute to strengthening the capacity of the municipal utilities to ensure effective planning, management, and implementation of energy saving activities.

See folder “Deliverables.”

*Deliverable:* Consultations to the staff of municipal enterprises on using the methodology provided

*Timeline:* October 2014 – September 2015

The MFSI-II Project experts provided recommendations for improving strategic planning in the context of city development priorities and a more realistic financial justification to the city of Vinnytsia Comprehensive Development.

Recommendations for the management of the Vinnytsia City Municipal Vinnytsiamiskteploenergo Heating Utility with regard to improving effectiveness of the financial justification of the Enterprise Strategic Development Program in the context of the city development priorities established by the Vinnytsia Development Strategy-2020.

See folder “Deliverables”

### ***Objective 3: Enhance public awareness of the budgeting process, revenues and expenditures, support and promote the “Citizens' Budget”***

#### **Task 3.1: Analyze the execution of budgets at all levels and the budget legislation, disseminate impartial information**

MFSI-II will prepare an independent budget implementation and budget legislation analysis to support the efficient and transparent implementation of local budgets. Thus, work will continue to analyze



the execution of budgets at all the levels and analyze budget legislation. In particular, in order to ensure the monitoring of the impact of the local revenues legislation amendments, the MFSI-II will constantly monitor the budget process at all of its stages. The monitoring findings will be presented in monthly and quarterly publications dedicated to the analysis of the budget execution. The monitoring and analysis findings will be disseminated among all the stakeholders and partners, including the GOU, IFIs, AUC, NGOs, and local governments.

*Deliverable: Monthly monitoring*

*Timeline: The monthly monitoring in electronic form is prepared and placed on the MFSI-II Project's Web-site (web-page) by the end of second week of every month*

In the reporting timeframe, the project prepared monthly monitoring reports (three for the reported period) on the implementation of the state and local budgets for the period from November 2014 to January 2015 (See "PMP"). The reports were placed on the website. On the whole, there were 39 monthly monitoring reports prepared and published on the website since the launch of MFSI-II.

See folder "Deliverables."

*Result: Monitoring of the budget and fiscal impacts on local budgets in form of a full-scale analysis of the budget process*

*Deliverable: Budget Monitoring*

*Timeline:*

*The Monitoring for Quarter 3, 2014 is placed on the Project's Web-page by December 31, 2014.*

*The Monitoring for Quarter 4, 2014 is published, distributed among the MFSI-II partners, and placed on the Project's Web-page by March 31, 2015.*

*The Monitoring for Quarter 1, 2015 is placed on the Project's Web-page by June 30, 2015.*

*The Monitoring for Quarter 2, 2015 is published, distributed among the MFSI-II partners, and placed on the Project's Web-page by September 30, 2015.*

In total, there were thirteen quarterly monitoring reports prepared and published on the website since the beginning of the MFSI-II Project.

According to the State Treasury preliminary data, MFSI Project experts prepared the *Budget Monitoring for January–December 2014* (See "PMP").

The monitoring included an analysis of the latest trends regarding the State and local budget execution, as well as an analysis of the legislative acts influencing the budget process, approved over the reporting period. *The Budget Monitoring* was distributed among the interested parties and stakeholders, and placed on the website. Key highlights include:

**The real GDP** decreased by 6.8ppt (in constant 2010 prices, year-on-year)<sup>8</sup>. At the same time, the European Union Member-States (EU-28) demonstrated the growth of real GDP by 1.3%, and the Eurozone countries by 0.9%.

**The nominal GDP** totaled UAH 1,566.7bn, which is UAH 111.8bn or 7.8% more than last year. The foreign markets situation remained unfavorable in 2014. This was one of the reasons behind the continued trend of declining industrial output. Thus, the industrial production index amounted to 89.9% in 2014 compared to 95.7% in 2013, and the producer price index increased by 30.1ppt to 131.8%.

**The foreign trade balance of Ukraine** was a positive one of \$5.1 billion in 2014.

**The nominal average monthly wage** per one full-time employee amounted to UAH 3,476.0 by the end of 2014, which is 6.5% more year-on-year. This exceeds the national social standards (the minimum wage level and able-bodied person's subsistence level, each amounting to UAH 1,218) by 2.9 times.

**The real wages** decreased by 6.5% (they increased by 8.2% in 2013). The retail trade turnover also declined for the companies engaged in retail and restaurant business (it totaled UAH 903.5bn, which is 8.6% less than in 2013 in comparable prices). This is indicative of the declining domestic consumer demand caused by the reduction in real wages, and thus, the diminishing purchasing power of the population.

In general, a shortfall of **revenues** was observed in budgets of all levels in 2014. For instance, the shortfall of the State budget of Ukraine amounted to UAH 21.0bn or 5.6% of the annual plan. The plan remained unfulfilled for all the key tax sources of revenues. In particular, the personal income tax shortfall against the plan amounted to UAH 1.5bn or 10.9%; the value-added tax shortfall to UAH 10.9bn or 7.3%; excise tax on goods made in Ukraine to UAH 3.8bn or 12.0%; import duty to UAH 3.2bn or 20.7%; and the fee for use of subsoil resources to UAH 2.2bn or 10.7%.

The only significant source of revenues with a recorded surplus over the annual target was the excise tax on goods imported in Ukraine, which generated UAH 3.8bn or 30.0% more than the plan.

The revenues of local budgets were also below the plan. Thus, the level of execution of the annual revenue plan approved by local councils amounted to 90.9%. A shortfall in the proceeds from the personal income tax was the main reason of the failure to fulfill the plan. A shortfall of local budgets under this item amounted to UAH 4.4bn or 6.1% of the plan. The situation was mitigated to some extent, however, thanks to revenues from the single tax, which exceeded the target by UAH 0.2bn.

**Break-down of Revenues of the Consolidated and State Budgets of Ukraine  
in January–December 2012–2014**

(%)

Revenues	Consolidated budget			State budget		
	2012	2013	2014	2012	2013	2014
<b>Tax revenues, including:</b>	<b>80.9</b>	<b>79.9</b>	<b>80.6</b>	<b>79.7</b>	<b>77.8</b>	<b>79.0</b>
– corporate profit tax	12.5	12.4	8.8	16.1	16.1	11.3
– value-added tax	31.2	29.0	30.5	40.3	38.0	39.2
– excise tax	8.6	8.3	9.9	10.8	10.5	12.7
– taxes on foreign trade and external transactions	3.0	3.0	2.8	3.8	3.9	3.5
<b>Non-tax revenues</b>	<b>18.2</b>	<b>19.2</b>	<b>17.6</b>	<b>19.8</b>	<b>21.6</b>	<b>19.2</b>
<b>Income from capital transactions</b>	<b>0.7</b>	<b>0.4</b>	<b>0.5</b>	<b>0.4</b>	<b>0.1</b>	<b>0.2</b>
<b>Targeted fund</b>	<b>0.2</b>	<b>0.2</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>
<b>Other revenues</b>	<b>0.0</b>	<b>0.3</b>	<b>1.2</b>	<b>0.0</b>	<b>0.4</b>	<b>1.5</b>

The abovementioned characteristics of the budget process with regard to revenues have shifted the structure of revenues of both the consolidated and State budgets. The most significant change involved an increase in the share of tax revenues (0.7ppt and 1.2ppt, respectively) and decrease in the share of non-tax revenues (-1.2ppt and -2.4ppt, respectively).

A decline in the share of tax revenues is observed in the structure of local budget revenues compared to last year. Still, the share of local taxes and fees continued growing (by 1.0ppt in the period under review). The main reason behind this is an increase in revenues from the single tax.

**The State budget deficit** totaled UAH 78.1bn, which amounts to 113.8% of the ceiling set by the Law on the 2014 State budget of Ukraine, and to 88.1% of the revised annual plan. Compared to 2013, the State budget deficit increased by UAH 13.4bn or by 20.7%.

**The State budget borrowing** totaled UAH 322.4bn (96.9% of the annual plan), including internal borrowing of UAH 227.6bn or 97.2% of the annual plan, and external borrowing of UAH 94.8bn or 94.8%. **The State debt repayment** totaled UAH 121.0bn, which amounts to 98.2% of the annual plan, including internal debt repayment of UAH 68.2bn or 99.6% of the annual plan, and external debt repayment of UAH 52.8bn or 96.5%. The excess of borrowing over repayment increased more than 2.5 times compared to last year.

According to the State Treasury Service, **the amount of the loans for covering temporary cash gaps of local budgets** provided from the treasury single account totaled UAH 28.1bn, which is 34.8% less than the respective figure of 2013<sup>9</sup>.

**The actual intake of proceeds from privatization of State property** totaled UAH 0.5bn, which is 2.7% of the amount approved by the 2014 State budget law, and 100.0% of the revised annual plan. Such proceeds totaled UAH 1.5bn or 13.6% of the annual plan in 2013.

**The balance of budget funds** totaled UAH 37.1bn at the end of 2014, having increased by UAH 6.3bn year-to-date. Based on the results of 2013 budget execution, the balance increased by UAH 3.7bn year-to-date.

**The level of execution of the consolidated budget expenditure plan** decreased by 2.6ppt year-on-year and amounted to 88.7%, with a 3.4% or UAH17.2bn growth in the actual amount of expenditures.

The rate of growth of the consolidated budget expenditures increased by 0.7ppt to 103.4%. Similarly to last year, it is lower than the GDP growth rate, which increased against 2013. The share of consolidated budget expenditures in GDP decreased slightly (down to 33.4% or by 0.4ppt).

The share of local budget expenditures in expenditures of the consolidated budget decreased by 0.4ppt year-on-year and amounted to 42.7%.

**The actual State budget expenditures** totaled UAH 430.1bn, which amounts to 93.0% of the annual target.

Those best funded were the expenditures for general government functions and defense (96.1% of the annual plan, which is 0.7ppt and 4.3ppt, respectively, more than last year), public order, security, and judiciary (95.5%), and inter-budget transfers, social protection, and social security (94.9% each). The lowest funding level is noted for the expenditures for environmental protection, with UAH 2.6bn or 67.5% of the annual plan spend for this purpose.

The main priorities of the State policy in the context of increased expenditures of the State budget compared to last year (59.0% of the total increase amount) included the expenditures for general government functions (they accounted for 32.5% of the whole increase of expenditures); inter-budget transfers (30.4%); defense (25.8%); public order, security, and judiciary (11.2%); and housing and communal services (0.1%).

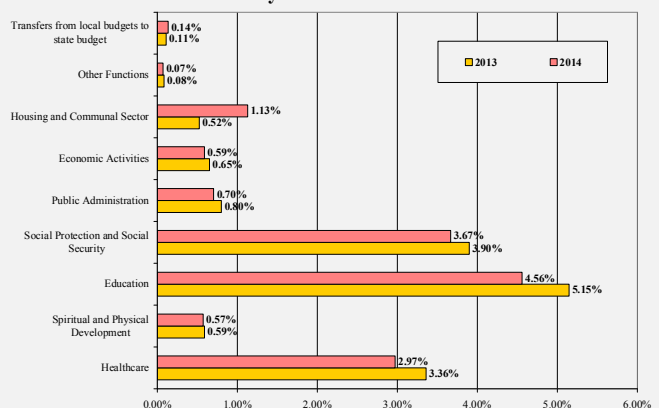
**The local budget expenditures (with inter-budget transfers)** increased only by 2.6% compared to last year and totaled UAH 225.6bn. The level of execution of the annual plan approved by local councils amounted to 84.4%. As usual, the majority of local budget expenditures are allocated for the social and cultural sphere.

In 2014, expenditures increased for culture and art (+9.8%), inter-budget transfers (+31.6%), and housing and communal services (+132.6%). The latter increased due to granting a State budget subvention to local budgets for repaying the debt for the difference in tariffs at the amount of UAH 12.4bn, whereas expenditures under the abovementioned subvention only amounted to UAH 2.1bn in 2013.

The share of expenditures for payroll with taxes is commonly the largest among all local budget expenditures. It decreased by 5.7ppt compared to last year and amounted to 41.3%.

Also, the amount of said expenditures decreased by UAH 10.2bn or 9.9% to UAH 93.2bn. On the whole, the current expenditures of local budgets totaled nearly UAH 211.7bn, which is 3.0% more than in 2013. The capital expenditures were funded at UAH 13.9bn, and their amount decreased by UAH 0.3bn or by 2.1%.

**Share of Local Budget Expenditures in GDP  
in January–December 2013–2014**



See folder “Deliverables.”

### **Task 3.2: Conduct public events and engage the public in the budget process**

In order to efficiently involve the public into the budget process, MFSI-II will support public hearings and deliver a number of trainings for the representatives of NGOs. This will assure that civil society organizations are prepared to serve as watchdogs of budget transparency and accountability. In addition, MFSI-II will continue its practices of holding meetings of the National Advisory Board and the Financial and Economic Forums on an ongoing basis, with an invitation extended to all the parties concerned, including the general public.

Therefore, in order to ensure the broadest possible dissemination of information at the local level and raise the level of public awareness, use will be made of all available mass media and other formats, such as public hearings, printed materials, etc.

When holding such events, MFSI-II will observe the principle of gender equality in carrying out an information and educational campaign as part of project implementation. MFSI-II will strive to attract on parity principles all the gender groups in the process of creating information products and implementing information campaign components. MFSI-II will also ensure equal opportunities for employees (women and men), contractors, and partners with regard to participating in project implementation, including the information component.

*Result/Deliverable: Participation of MFSI-II experts in working meetings, roundtables, conferences, including international ones, radio and TV talk shows with the aim of disseminating information on the issues addressed by the project*

*Timeline: Continuously*

**On 2 October 2014** MFSI-II experts participated in Budget Efficiency, Transparency and Responsibility workshop that was organized with the assistance of GIZ Ukraine.

The representatives of the Secretariat of the Parliamentary Committees, public council of the Ministry of Finance of Ukraine, nongovernmental organizations and scientific circles were invited to discuss urgent issues raised by Gerd Ehlers, former State Secretary at the German Federal Minister of Finance.

Within the workshop, the principles of transparent and effective budgeting, privatization, public and private partnership were discussed based on the German experience and European standards.

As the result, the participants of the workshop improved their knowledge of transparent budget expenditures and high-quality state finance management.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 10 October 2014**, the MFSI-II Project participated in a roundtable “Ukraine’s Health System Financing” upon invitation of the USAID Public Private Partnership Development Program and the American Chamber of Commerce in Ukraine.

The Ministry of Health of Ukraine, Ministry of Finance of Ukraine, 3,000 International Charitable Foundation, New Social and Economic Policy Analytical Center, international experts, representatives of local authorities, business and public organizations were present at the discussion.

The participants discussed the implementation of public private partnership (PPP) in terms of health care and health care reform.

During the meeting, the participants studied PPP experience in health care in Ukraine and abroad. They also addressed issues that require improvements in the Ukrainian legislation as part of introduction of PPP (Budget Code, laws and bylaws), including:

- long-term budget obligations to be taken by a public partner based on PPP contracts, and fulfilled within the validity periods of such contracts;
- fair and real compensation to be paid by a public partner to a private partner for early termination of



the PPP contract to reimburse the private partner for its reasonable loss (based on the termination causes).

A legal response to the issues raised above will ensure the investments in health care based on PPPs, promote solving actual problems in this sphere, and improve the overall quality of medical services in Ukraine.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 15 and 16 October 2014**, the MFSI-II Project took part in the seminar on Implementation of Accrual Basis of Accounting in the Public Sector organized by the Ministry of Finance of Ukraine under the Public Finance Reform Support Project with support from the German International Cooperation Society (GIZ).

The event was attended by the Ministry of Finance of Ukraine, Accounting Chamber, State Treasury Service, State Financial Inspectorate, State Fiscal Service, State Financial Monitoring Service, leading scholars, and representatives of non-governmental organizations.

The participants heard presentations delivered by German expert Stefan Schmidt on the advantages of implementing accrual basis accounting, principles of preparing financial accounts based on IPSAS International Accounting Standards, and had an opportunity to learn about practical aspects of applying the accrual method in Germany. Special focus was made on opportunities for using the accrual accounting data in public administration.

The covered issues are very topical and their implementation will make it possible to bring Ukraine closer to European accounting and reporting standards.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 29 October 2014**, representatives of the MFSI-II Project took part in a meeting of Ukrainian financial officers organized by the Association of Ukrainian Cities under the USAID Development Initiative for Advocating Local Governance in Ukraine (DIALOG) Project.

The meeting participants discussed proposals for amending the Law of Ukraine “On the State Budget of Ukraine for the Year 2014” and formation of the Draft State Budget for 2015.

In addition, the participants discussed the legislative drafts on amending the Budget Code and Tax Code of Ukraine, in particular, with regard to budget decentralization, and agreed their proposals for improving the amendments to the Budget Code intended to strengthen the financial base of local government.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 30 October 2014**, the MFSI-II Project attended the “Energy Performance Contracts as the Road to Country's Energy Efficiency” conference. The conference was hosted by the Regional Office of the Friedrich Ebert Foundation in Ukraine.

The event was attended by National Deputies, government ministries, State Agency for Energy Efficiency and Energy Conservation of Ukraine, nongovernmental organizations, businesses, academic circles, and mass media.

The conference was intended to hold presentations and public discussion on legislative drafts related to ESCO mechanisms in Ukraine, namely:

- “On Amending the Law of Ukraine “On Energy Conservation” with Regard to Legal Foundations for Implementation of Energy Performance Contracts;”
- “On Special Features of Conducting Energy Service Procurements;”
- “On Amending the Budget Code of Ukraine (with Regard to Implementation of Energy Efficiency Activities in Government-Funded Institutions),” which was developed with direct participation of the MFSI-II Project experts.



The legislative drafts are designed to remove barriers to implementing energy efficient projects with the participation of private investments.

The participants discussed the strengths and weaknesses of the legislative drafts and opportunities for their unification.

Adoption of the appropriate legislative framework would promote energy conservation in general, development of energy markets, and growth of the market of energy service companies.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 5 November 2014**, experts of the MFSI-II Project took part in a regular meeting of the Resuscitation Reform Package (RRP) initiative focusing on energy sector reform. The key issue of the meeting involved an accelerated adoption of the legislative amendments, in the development of which the MFSI-II experts have been engaged, with regard to opportunities of attracting private capital in energy saving activities in the public sector (ESCO).

The abovementioned legislative amendments are currently being in the process of approval at the Ministry of Finance, Ministry of Economic Development, and other interested ministries. The MFSI-II experts provided clarifications to answer some of the conceptual questions asked by RRP participants, which they had raised before the MinRegion earlier, and which provoked some opposition on the part of RRP with regard to said versions of the legislative drafts. The meeting participants decided to somewhat clarify the wording of the legislative drafts to provide a better transparency for the developed mechanism of concluding energy performance contracts. As the result, the MinRegion, as a Government ministry responsible for development of those legislative amendments, is to garner support of a wider circle of experts with regard to the need of their adoption. It can help submission of the legislative amendments to the Verkhovna Rada of Ukraine.

As noted earlier, adoption of the amendments to the main budget law developed with participation of MFSI-II Project experts will help to settle the problem issues hampering implementation of energy performance contracts at the legislative level for the first time. This would give a boost for further lessening of energy dependence of Ukrainian cities.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 7 November 2014**, experts of the MFSI-II Project were invited by ADTEF to take part in a roundtable meeting at the Ministry of Regional Development, Construction, Municipal and Housing Services of Ukraine (MinRegion) and join in a debate around the issue of relevance of implementation of Public Private Partnerships in Ukraine, in particular, in the water service sector.

The meeting participants were familiarized with the French experience in the sector, as well as the Ukrainian experience and actual situation, discussed the key problems, which need to be addressed to attract private investments into high-value investment projects at State/municipally-owned facilities.

Based on the discussion results, the participants agreed to continue activities of the working group at the Ministry of Economic Development, which should take part in developing legislative drafts and bylaws required for effective operation of Public Private Partnerships in Ukraine. The MFSI-II Project experts could assist in the work of said working group by developing the needed amendments to the budget legislation.

Implementation of PPPs in Ukraine will provide for a significant renewal of obsolete and worn-out capital assets in the utilities sector, will increase population access to quality services, and improve the environmental situation.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 12 November 2014**, the MFSI-II Project attended the Attracting Private Investments in Energy

Efficiency Projects in Buildings of Government-Funded Institutions in Ukraine: Regulatory Reform and Further Steps roundtable held by EBRD. The meeting was also attended by USAID, Ministry of Regional Development, Construction, Municipal and Housing Services of Ukraine (MinRegion), State Agency on Energy Efficiency and Energy Saving of Ukraine (Derzhenergoefektyvnosti), Ukrainian cities, and others.

The meeting focused on a discussion of legislative changes regarding opportunities for engaging private capital in energy-saving activities in the government-funded sector (ESCOs). The Project was involved in developing the new legislation. The Project delivered a presentation on the respective legislative proposals to the Budget Code to the roundtable participants, and the representatives of cities expressed their reservations with regard to the proposed mechanism. As the result of the discussion, the participants supported the need to adopt these legislative changes and requested that in the course of development of relevant bylaws provisions should be incorporated that address the expressed reservations.

As noted earlier, adoption of the amendments to the main budget law developed with the participation of the MFSI-II Project will make it possible for the first time to settle issues that have inhibited implementing energy service contracts at the legislative level. These changes will help to further reduce the energy dependence of Ukrainian cities.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 18 November 2014**, the MFSI-II Project took part in an international seminar on the topic of Fiscal Decentralization in Ukraine organized as part of the Ukrainian-Swedish project to support decentralization in Ukraine.

The event was attended by representatives of both the central and local governments, local government associations, members of Ukrainian parliament, leading Ukrainian and international experts.

The key topic for discussion was decentralization reform in Ukraine, its financial cross-sectoral aspects, and presentations of best European experience in these matters. The attendees heard presentations on special features of decentralization efforts in the European countries delivered by Swedish experts, and had an opportunity to learn about the practical aspects of implementing decentralization in Sweden. Special focus was made on the legislative drafts prepared by the government for implementing fiscal decentralization in Ukraine.

Based on the meeting results proposals have been developed to be taken into account when finalizing the legislation on implementing decentralization in Ukraine.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 19 November 2014**, the MFSI-II Project experts had a meeting with the IMF mission, involving Steve Gonyea, Director, Economic Growth Office, USAID.

The meeting focused primarily on the Ukrainian Government’s initiatives to introduce a new model of inter-budget relations and strengthen the financial capability of local governments (draft Law on Amending the Budget Code of Ukraine No. 5078 dated 15 September 2014). The Project shared its analysis and proposed changes and also contributed to the discussion of key provisions of the legislative draft.

During the meeting, a separate objective was to address the achievements of the USAID-supported MFSI and MFSI-II Projects. In particular, the mission team looked into the results of piloting performance program budgeting at the local level and municipal fund-raising for the implementation of energy-saving projects.

The mission team appreciated outcomes of the discussion with the Project concerning the issues raised by them and pointed out the helpfulness of the professional analysis of major trends in the Ukrainian economic and budgetary indicators over 2012-2013, developed under the Project and presented in periodic budget monitoring updates.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

The MFSI-II Project took part in a roundtable meeting on the topic of Challenges, Practices, and Strategy of Reform Implementation in Regions of Ukraine: Ukraine 2020. The event was held by the National Institute of Strategic Studies on **19 November 2014**.

The meeting was attended by officials from the government ministries and agencies, leading experts and researchers, representatives of local government and non-governmental organizations.

The participants discussed the ways of ensuring the growth of independence of the regions, building an effective institutional and legislative framework for the new state regional policy, and other topical issues of reform implementation at the regional level.

The Project presented proposals with regard to the need to accelerate the introduction of new social living standards for the populace, ensure transparency in the ways of implementing of reforms, and their promotion among the general public.

The proposals provided by the Project will be incorporated into a resolution to be prepared based on the meeting results.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 24 November 2014**, the MFSI-II Project took part in a meeting of the Resuscitation Reform Package initiative group, which is dealing with energy sector reform issues.

This special meeting was devoted to discussing the legislative changes that will enable private capital to be utilized for energy saving activities in the budget sector (ESCO). The Project took part in the development of these changes.

The meeting’s participants noted the extensive and fruitful work implemented in preparing the legislative drafts "On Amending the Law of Ukraine “On Energy Conservation” with Regard to Legal Foundations for Implementation of Energy Service Contracts," "On Special Considerations in Energy Service Procurements," and "On Amending the Budget Code of Ukraine (with Regard to Implementation of Energy Efficiency Activities in Government-Funded Institutions)."

The participants have also pointed to the need to accelerate the adoption of the legislative drafts, as this would ensure the introduction of energy service contracts in the public sector, and they agreed to improve the developed legislative drafts if needed.

The adoption of these legislative drafts will empower government-funded institutions to conclude energy service contracts, which, in turn, will facilitate efficient energy consumption in the public sector and reduce the amount of energy resources used.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 11 December 2014**, the MFSI-II Project took part in a meeting of the coordinating group of donors in the field of public finance management under the auspices of the Ministry of Finance of Ukraine. The meeting was also attended by specialists in the field of finance and representatives of international donor institutions.

The participants discussed the priorities in developing a public finance management system and the vectors of donor support, as well as further strategies for the development of cooperation between the government and the donors. Individual projects presented the results of their activities in the sector of public finance management in the country.

During her presentation, department head O. Shvedenko from the Ministry of Finance Department of Cooperation with International Organizations and Coordination of International Technical Assistance made a special note of the achievements of the MFSI-II Project and gave details of the key groundwork completed by the project in the previous period.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 11 December 2014** the MFSI-II Project attended a working meeting with State Energy Efficiency and Energy Saving Agency (Derzhenergoefektyvnosti) focused on finalizing the draft of legislation providing opportunities for engaging private capital for energy conservation projects in the public sector (ESCOs). The meeting was also attended by the Ministry of Regional Development, Construction, Municipal and Housing Services of Ukraine (MinRegion).

These legislative changes, which were developed with Project assistance, are currently being finalized at an accelerated rate, in particular, with the aim of incorporating suggestions made by stakeholders. The finalized legislative drafts are expected to be submitted to the Verkhovna Rada of Ukraine in the near future.

*Reference: On 9 and 11 December 2014, similar legislative drafts were registered by MPs at the Verkhovna Rada of Ukraine. There are also amendments to the Budget Code identical to the legislative draft developed with Project participation.*

The adoption of these amendments will make it possible for the first time to resolve problem issues preventing the introduction of energy service contracts at the legislative level. This will give a great boost to the energy independence of Ukrainian cities.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 19 December 2014**, experts of the MFSI-II Project took part in a roundtable of the Resuscitation Reform Package (RRP) group to discuss the proposals to the Concept of implementation of energy service company (ESCO) mechanism. The meeting was attended by representatives of international organizations, law firms, leading energy efficiency experts, representatives of non-governmental organizations and others.

The main objective of the event was discussing the strategy of further work with the legislative drafts, which regulate the possibilities for concluding energy service contracts, including those legislative drafts in whose development MFSI-II experts took part.

The meeting participants noted significant and fruitful efforts of preparing the legislative drafts undertaken with the Ministry of Regional Development, Construction, Municipal and Housing Services of Ukraine (MinRegion) and the State Energy Efficiency and Energy Saving Agency (Derzhenergoefektyvnosti): “On Amending the Law of Ukraine “On Energy Conservation” with Regard to Legal Foundations for Implementation of Energy Service Contracts,” “On Special Considerations in Energy Service Procurements,” and “On Amending the Budget Code of Ukraine (with Regard to Implementation of Energy Efficient Activities in Government-Funded Institutions).”

At the same time, similar legislative drafts have been registered at the Verkhovna Rada of Ukraine, which drafts are significantly repeating the provisions developed by the MinRegion and Derzhenergoefektyvnosti, however, contain a number of drawbacks. Therefore, a decision was made at the meeting to prepare comments and proposals to the registered legislative drafts, and also continue collaboration with the MinRegion and Derzhenergoefektyvnosti to finalize the legislative drafts developed by them.

The RRP experts are expected to participate in a meeting of the Verkhovna Rada Committee on Fuel and Energy Complex, Nuclear Policy, and Nuclear Safety to discuss the abovementioned registered legislative drafts on Wednesday, 24 December 2014.

Adoption of the developed legislative drafts will make it possible for government-funded institutions to conclude energy service contracts, which, in turn, will promote efficient use of energy in the public sector and reduced consumption of energy resources.

Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)



**On 15 January 2015**, a team from the Municipal Finance Strengthening Initiative (MFSI-II) Roll-out Project took part in a seminar on the topic of Medium-Term Budget Planning and Forecasting sponsored by the German Society for International Cooperation (GIZ).

The seminar was attended by representatives of nongovernmental organizations, officials from the Ukrainian Ministry of Finance, Parliament, academic community, and others.

The attendees heard a presentation delivered by Gerd Ehlers, who is a former State Secretary of the German Federal Ministry of Finance and an expert on Germany's public finance management..

The event covered issues of financial planning as a tool of budget process management in the context of German experience and European standards. Special focus was placed on medium-term financial planning, and specifically, on five-year financial planning. The German expert provided recommendations for the annual preparation of financial plans and stressed its important economic and political significance.

The implementation of such recommendations will strengthen financial self-discipline as well as promote transparency and the effectiveness of Ukraine's financial policies.

Upon invitation of the State Agency on Energy Efficiency and Energy Saving (*Derzhenergoefektyvnosti*), **on 17 January 2015**, experts of the MFSI-II Project took part in a meeting on finalizing the legislative drafts on opportunities for attracting the private capital into energy saving activities in the public sector. The meeting chaired by the Derzhenergoefektyvnosti Chairman, Serhiy Savchuk, was also attended by representatives from the Ministry of Regional Development, Construction, and Housing and Communal Services of Ukraine (Minregion), EBRD, MP assistants, members of the expert community, and other stakeholders.

The meeting was devoted to agreeing the key controversial issues contained in the two packages of legislative amendments on the matter registered with the Verkhovna Rada.

*Reference: On 9 and 11 December 2014, members of the Ukrainian Parliament registered separate similar legislative drafts at the Verkhovna Rada of Ukraine. Notably, amendments to the Budget Code duplicate the legislative draft developed with participation of MFSI-II experts.*

As the result of the meeting, all the participants reached an agreement regarding said controversial issues and it was decided that a jointly finalized legislative draft would be put to the vote by MPs, which would significantly improve the likelihood of its acceptance and signing by the President of Ukraine.

As mentioned earlier, adoption of the amendments to the main budget law drafted with participation of the MFSI-II Project experts will make it possible for the first time to resolve the problem issues preventing from implementation of energy service contracts at the legislative level. This will give a boost to further lessening of energy dependence of Ukrainian cities.

Experts of the MFSI-II Project took part in finalizing the legislative drafts passed in the first reading by the Verkhovna Rada of Ukraine on 5 February 2015, which would remove the main barriers to attracting private capital for reducing energy consumption by government-funded institutions. One of the legislative drafts intended for this purpose involves amendments to the Budget Code in whose development the MFSI-II experts participated directly.

A working meeting devoted to finalizing said legislative drafts **on 12 February 2015** arranged by EBRD was also attended by representatives of the State Agency on Energy Efficiency and Energy Saving, MPs, and other stakeholders.

The meeting participants have reached a preliminary agreement with regard to the required amendments to said legislative drafts, which need to be taken into account for adopting the bills in the second reading. It is planned to ensure finalizing of the legislative drafts within a short period of time and submit them for review of the relevant committees of the Verkhovna Rada of Ukraine.

As noted before, adoption of said legislative drafts will ensure:

- transparent arrangements of conclusion and implementation of energy performance contracts;

- attractiveness of the public sector for potential investors in energy saving by guaranteeing the protection of their rights; and
- reduced energy dependence of Ukrainian cities.

**On 20 February 2015**, MFSI-II experts took part in a seminar entitled Requirements for Filling out a Report According to the Rules of the Extractive Industries Transparency Initiative in Ukraine (EITI) organized by the Tax Consultants' Chamber NGO. According to EITI, both companies and the Government must disclose the information about the payments for use of natural resources and make sure that such proceeds are used for the benefit of citizens.

During the seminar, the participants were familiarized with EITI requirements, its implementation in Ukraine, international experience with regard to special considerations in the preparation and submission of reports, and the mechanism of development and analysis of EITI Report in Ukraine. Also, the participants were introduced to the EITI Report Template for extractive industries in Ukraine, which the oil and gas sector companies must submit already this October.

Given that one of the EITI objectives is transparency and citizen control over the Government and business in the matters of independent management of natural resources, MFSI-II experts are shortly going to provide their recommendations with regard to the content of the abovementioned template.

**On 13 March 2015**, the MFSI-II Project took part in a working meeting with the Ministry of Energy and Coal Industry of Ukraine (MoECI) with regard to the Extractive Industries Transparency Initiative (EITI).

The meeting focused on the main tasks MoECI is facing in implementing EITI and the assistance the Ministry is expecting from the Project in the immediate future. As a result, the participants agreed that by 27 March 2015, the Project, as a participant in drafting the regulatory and methodological framework for EITI implementation, will submit to the Ministry:

- proposals for the latest version of the legislative draft, which would enable EITI implementation in Ukraine;
- proposals for the latest version of the template for reports from extraction companies under EITI;
- recommendations for the Scope of Work of the Independent Administrator, which is to compile the First National Report on implementing the Extractive Industries Transparency Initiative in Ukraine in 2013.

The above activities will contribute to the transparency and openness in the extraction industries and will enable the general public to take part in overseeing the management of Ukraine's natural resources.

**On 20 March 2015**, experts of the MFSI-II Project took part in a meeting of the Committee on Budget of the Verkhovna Rada of Ukraine devoted, among other things, to finalizing for adoption the changes to the Budget Code approved in the first reading, which changes are required for removing the main barriers to attracting private capital for reducing energy consumption by government-funded institutions.

Speaking at the meeting, some MPs suggested the amendments to said changes, which would undermine the ideology of the legislative draft and make it impossible to concluded energy performance contracts in the public sector. Thanks to the work conducted by MFSI-II experts jointly with MPs, representatives of the State Agency on Energy Efficiency and Energy Saving, and the EBRD, the Budget Committee members have rejected said amendments. As the result, the meeting approved the proposals of the legislative draft's authors for preparing the final version for the second reading.

**On 31 March 2015**, upon invitation of the Ministry of Energy and Coal Industry of Ukraine, experts of the MFSI-II Project took part in a scheduled meeting of the Multi-Stakeholder Group (MSG) on implementation of the Extractive Industries Transparency Initiative (EITI) in Ukraine.

The participants discussed at the meeting the key issues of EITI implementation in Ukraine and



approved, with a condition of finalizing within a three days' period, the following:

- Technical Specifications for the Independent Administrator, which will compile the First National Report on implementation of the Extractive Industries Transparency Initiative in Ukraine for the year 2013; and
  - the forms of report template for extractive companies under EITI;
- the proposals and recommendations for which were presented by the MFSI-II Project experts on 30 March 2015.

*Result: Preparation and organization of Financial-Economic Forum*

*Deliverable: Minutes of Financial-Economic Forum, agenda and recommendations of Forum participants*

*Timeline: February 2015, September 2015*

*Result: Preparation and organization of a National Advisory Board*

*Deliverable: Minutes of a National Advisory Board and agenda*

*Timeline: December 2014, March 2015, June 2015, August 2015*

**On 29 December 2014**, a regular meeting of the National Advisory Board (NAB) on efficient management of public finance was held. It was attended by the representatives of the Ministry of Finance of Ukraine, financial departments of municipal councils, academia, civil society and international experts.

During the session, the participants summed up the 2014 work on implementation of advanced budgeting methodologies and in particular PPB, peculiarities of formulation of local budgets for the next year, as well as IBSE's performance results for 2014 and plans for 2015.

The participants highly appreciated operation of the MFSI-II Project in terms of improving the legislative and methodological framework of program performance budgeting in local budgets and supporting its implementation. They also highlighted the needed further support for PPB implementation and development at the level of local budgets and methodology improvement at the state budget level, in particular, with participation of MFSI-II experts in this lengthy process. Moreover, they noted that with the current shortage of budget resources special attention should be paid to the budget spending efficiency and performance assessment.

**Meeting of the National Advisory Board (NAB) on efficient management of public finance, 29 December 2014**



Accomplished (see “Quarterly Report 01 October – 31 December, 2014”)

**On 10 February 2015**, a joint meeting of the representatives of MOF, heads of local financial authorities, and the National Advisory Board on effective public finance management took place at the Ministry of Finance of Ukraine. The conference was attended by specialists of the Ministry of Finance, Treasury Service of Ukraine, President's Administration, Cabinet of Ministers, VR Committee on Budget, heads of local financial authorities from all Ukrainian regions, representatives of MPs and the civil sector.

The participants discussed at the meeting the topical issues of implementing a reform of the budget system of Ukraine. Directors of the Ministry of Finance departments characterized the key aspects of changes to the budget legislation and provided clarifications with regard to interpretation of new standard provisions of the Budget Code. The heads of local financial authorities shared their experiences of applying the amendments to the Budget Code, noted positive changes in the budget legislation, and pointed out to the problem issues, which require further changes and resolution.

The meeting participants expressed their high appreciation of the work conducted by the MFSI-II Project and noted the need for further support to realization of budget legislation reform. The next step in close collaboration between the Ministry of Finance and MFSI-II will involve delivery of a series of regional training seminars for the representatives of local financial authorities.

See folder “Deliverables.”

**Meeting of the National Advisory Board (NAB) on efficient management of public finance, 10 January 2015**



***Result/Deliverable:** Regular updating of IBSER website with information regarding project activities*

***Timeline:** Ongoing process*

The MFSI-II website is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II Project experts participated in the period of October – December 2014 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (soft copies), prepared in the period October – December 2014, have been placed on the site in the Subsection – “Analytical materials” (in Ukrainian and English).

Useful References (subsections – Media about us; Our Partners).

All articles published in national and regional media in October – December 2014 have been monitored and converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

The IBSER Facebook page is updated and all news and photos from events and workshops were placed.

New set of questions in section “Answers by Experts” with experts answers related to the PPB section was regularly added to the website, the information was regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation, was updated.

**Accomplished** (see “Quarterly Report 01 October – 31 December, 2014”)

The MFSI-II website is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II Project experts participated in the period of January – March 2015 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (soft copies), prepared in the period January – March 2015, have been placed on the site in the Subsection – “Analytical materials” (in Ukrainian and English).

Useful References (subsections – Media about us; Our Partners).

All articles published in national and regional media in January – March 2015 have been monitored and converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

The IBSER Facebook page is updated and all news and photos from events and workshops were placed.

New set of questions in section “Answers by Experts” with experts answers related to the PPB section was regularly added to the website, the information was regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation, was updated.

*Result: Preparation of Electronic bulletin intended for the publication of news on project activities for electronic mailing to addressees in the database of IBSER partners*

*Deliverable: Electronic bulletin*

*Timeline: October 2014, January 2015, April 2015, July 2015*

One Bulletin issue (#44 October – December 2014) has been prepared in Ukrainian and English and e-mailed to more than 687 partners. It is also placed on the project website in the “E-Bulletin” section. Overall, ten Bulletins have been prepared since the launch of the MFSI-II Project.

See folder “Deliverables.”

*Result/Deliverable: Publication “Innovative Practices of Local Finance Management”*

*Timeline: March 2015*

MFSI-II experts have prepared an annual publication of *Innovative Practices: Local Finance Management – 2014 Results*, which provides illustrations of the results of execution of budget programs and energy performance projects, and highlights the successful experience of realization of strategic programs and PPB implementation. The publication is intended for a wide audience and is expected to help popularize the achievements and best practices of PPB at the local level.



See folder “Deliverables”

*Result: Support the holding of separate information public events in partner cities*

*Deliverable: The report on implementation of information public events in localities prepared*

*Timeline: August 2015.*

**On 23 February 2015**, a roundtable on the topic *Realization of an Experiment for Implementation of the Performance Program Budgeting Method in the Chervonohrad City Budget* was conducted with support from the MFSI-II Project in the city of Chervonohrad, Lviv oblast.

This public event was attended by members of the City Council, key spending units of the city budget, and members of the press.

Speaking at the meeting, the participants summed up the results of execution of the 2014 performance program budget and discussed the outcome of the experiment of introduction of the performance program budgeting method in the city's budget process, as well as noted the importance of PPB as the essential precondition for efficient use of budget funds, improving the quality of social services, saving of energy resources etc.

This public discussion of the topical issues of formulation and execution of the city budget has allowed to improve the awareness of citizens about the use of budget funds and facilitated the development of the proposals to be addressed in the course of execution of the 2015 budget.

See folder "Deliverables."

**Roundtable: Realization of an Experiment for Implementation of the Performance Program Budgeting Method in the Chervonohrad City Budget, City of Chervonohrad, 23 February 2015**



**Result:** *Delivery of training on budget issues for NGOs*

**Deliverable:** *Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender*

**Timeline:** *January – March 2015*

**On 19 December 2014**, MFSI-II experts delivered a training for representatives of nongovernmental organizations. The training was attended by 26 representatives of youth NGOs from the city of Mykolaiv.

Young people in Ukraine have very limited knowledge about either the budget process or the reforms launched in Ukraine. This impairs the level of their participation in both in the formulation of local budgets, and control over efficient use of budget funds.

To engage youth in the budget process, the MFSI-II experts have introduced the training participants to the basics of budget legislation, and the problem issues in the performance of local budgets. Special focus was made on discussing the budgetary and financial decentralization and its implications for budgets at all levels.

A proactive participation of the public will increase the efficiency of budget spending, significantly improve the budget process transparency, and help reduce corrupt practices.

**Training "About the Budget in Plain Language" City of Mykolaiv, 19 December 2014**



**Accomplished** (see "Quarterly Report 01 October – 31 December, 2014")



**On 28 January 2015**, MFSI-II experts conducted a training for the representatives of nongovernmental organizations from the Mykolaiv oblast on the issues of formulation and execution of local government budgets. The training was attended by the representatives of 30 NGOs from the Mykolaiv oblast.

Discussed in the course of the training were the problem issues of formation and execution of budgets of the territorial communities of villages, settlements, and raion-subordinated cities. The experts focused on covering the implementation of the latest changes in the budget legislation and organization of the budget process in 2015-2016.

Awareness of the general public about the principles of budget relations reform and the basic budgeting foundations will help engage the population in making the managerial decisions aimed at efficient use of budget funds, creation of proper conditions for local governments' performance of their own and delegated functions, and improved transparency of the budget process.

See folder “Deliverables.”

*Training: The Problems of Formulation of Local Budgets in the Environment of Changing Budget Legislation, City of Mykolaiv, 28 January 2015*



### **Task 3.3: Conduct public events and engage the public in the budget process**

Banking on international experience, MFSI-II will develop a “Citizens' Budget” methodology for shaping informational and analytical materials on the key indicators and objectives of the State Budget in a form, which would be easy-to-understand for the public. Just like in the leading countries overseas, such informational and analytical materials will contain information about the State Budget and budget legislation in a form, which would be easy-to-understand and clear for the wide public. The said methodology will be proposed to the Ministry of Finance of Ukraine for the purpose of the regular web-publication of the budget-related information. Its presence in public domain will ensure readiness of civil society organization to act as watchdogs for budget transparency and accountability.

Strengthened independent civic watch over budget spending and active involvement of the public in the budget process will bring about reduced lesser corrupt practices in it.

*Deliverable: A “Citizens' Budget” methodology developed*

*Timeline: January – September 2015*

Experts of the MFSI-II Project have launched the activities designed for implementation of the Citizens' Budget. A working meeting between MFSI-II experts and representatives of the Kyiv City Council and Kyiv City Administration was held on **13 March 2015**. The main topic of the discussion concentrated on looking into the opportunities for implementation of the Citizens' Budget in the city of Kyiv.

Discussed at the meeting were the opportunities for the formation of the city budget in a format comprehensible for the general public. Based on the meeting results, areas for further cooperation have been determined.

This will help develop an effective methodology for the formulation of information and analytical

materials on the main indicators and tasks of the budget, in a format comprehensible for citizens.

Development of materials based on one of the largest local budgets in Ukraine will make it possible to reveal both the strengths and weaknesses in the budget process. Subsequently, such work will allow to strengthen transparency and accountability of budgets at all levels.

***Objective 4: Improve the internal audit methodology based on performance program budgeting (PPB) as a tool for preventing corruption in the budget process***

**Task 4.1: Analyze the legislative and methodological framework for internal oversight and audit at the national level**

MFSI-II will analyze the legislative and methodological framework for internal oversight and audit at the national level in order to identify criteria for development of a methodology for such an audit based on PPB. Sub-task 5.1.3 will also include a series of trainings on the PPB methodology and evaluation of the performance of budget programs for internal oversight and audit specialists.

*Deliverable: A completed analysis of the legislative and methodological framework for internal oversight and audit at the national level*

*Timeline: January – June 2015*

MFSI-II experts have started the work of developing proposals for improving the efficiency of internal oversight and audit. To this end, they have launched a review of the legislative and methodological framework of internal oversight and audit implemented at the national level.

**Task 4.2: Improve the internal auditing methodology**

In order to provide for sound methodological support of internal auditing, MFSI-II will develop a methodology for internal auditing of efficiency based on PPB and modules for training materials on its application. The modules will contain, among other things, guidelines for specialists auditing the formation and execution of the State Budget, in particular on the identification of possible corruption risks and challenges, as well as the development of recommendations subsequent to internal auditing.

Both PPB and the need for improved internal oversight mechanisms will be discussed at roundtables involving civil society members, such as the group under the “Resuscitation Package of Reforms.” This will add comprehensive inputs to the budget transparency initiatives.

*Deliverable: A methodology for internal efficiency audit based on PPB and training modules developed*

*Timeline: April – September 2015*

***Objective 5: Strengthen PPB implementation for the state budget as a mechanism to reduce corruption in the public sector***



**Task 5.1: Assist central executive authorities (Ministry of Finance of Ukraine and other key ministries) in finalization of the PPB methodology*****Sub-task 5.1.1: Develop a modern PPB methodology for the State Budget***

MFSI-II will provide the Ministry of Finance of Ukraine with technical assistance in improvement of the PPB methodology and, in particular, the structure of budget programs, their performance indicators and medium-term PPB-based budgeting.

Based on programs and focused on efficiency, the State Budget with a clear-cut programmatic structure, well-identified goals and informative performance indicators not only will become a robust tool for managing public resources, but also will lay down solid fundamentals for combating corruption within the public finance management framework and improve transparency and accountability in the budget process.

The said proposals will be considered at roundtables or meetings of the NAB, which will be attended by members of the Verkhovna Rada of Ukraine, experts of specialized parliamentary committees, Ministry of Finance of Ukraine, line ministries and representatives of the civil society. Once agreed with stakeholders, the methodology will be presented to the Ministry of Finance of Ukraine for approval and use.

During the fourth year of implementation, MFSI-II will:

- develop a methodology, which would determine approaches to shaping medium-term budget programs, their structure, and efficiency indicators, including budget programs with capital investments and energy saving measures effected. If necessary, draft amendments to legislative acts;
- draw up proposals on improvement of the forms of budget requests and budget program passports in terms of expenditures on investment programs (projects) and energy saving measures to provide for the medium-term approach.

*Deliverable: Amendments to legislative acts (if necessary) and bylaws that stem from the new methodology*

*Timeline: January – September 2015*

*Deliverable: Proposals on improvement of the forms of budget requests and budget program passports in terms of expenditures on investment programs (projects) and energy saving measures*

*Timeline: January – September 2015*

***Objective 6: Assist in implementation of the Extractive Industries Transparency Initiative (EITI) in Ukraine*****Task 6.1: Develop capacity of a multi-stakeholder group for the successful preparation and publication of EITI reports**

MFSI-II will provide for trainings, materials, advisory support and a study tour to a country compliant to the EITI requirements in order to building the capacity of the MSG. Although involving all the MSG members into capacity building is essential, it is critical that the GOU (specially, the Ministry of Energy and Coal Industry) be a pro-active counterpart in this domain.

For the purpose of preparing proper EITI reports, the multi-stakeholder group has to identify necessary information about revenues of and payments by the extractive industries, analyze it and then present the analysis in a helpful and clear-cut report.

MFSI-II will draw up soft and hard copies of a manual on EITI implementation in Ukraine. Among other things, it will cover international experience, principles of EITI use in Ukraine and prospects for expansion of EITI areas, particularly in terms of budget expenditure transparency and oversight. These materials will be used for training MSG members and relevant non-member civil society organizations in order to strengthen their capacity in EITI implementation in Ukraine. They will also contain reporting forms compliant with EITI standards, which will foster information submission by extractive companies or compiling relevant information about revenues. The proposed materials will be furnished with MSG representatives for consideration.

MFSI-II will develop and train MSG members and relevant non-member civil society organizations in understanding and analyzing budget information, which is necessary for preparation of proper EITI reports on Ukraine. This training may include background information on budget and fiscal transparency, but should be focused on the extractive industries and assist in translating sophisticated budget information into an information, which would be helpful for Ukrainian citizens. In addition to basic training, MFSI-II will have a training for trainers who are MSG members in order to expand the scope of the MSG's activity and support better public understanding, oversight, transparency of, and disclosure by the extractive industries.

MFSI-II will arrange a study to an appropriate EITI member-state, such as Norway, for relevant MSG members and stakeholders. Once completed, MFSI-II will sum up the outcomes and recommendations of its participants. MFSI-II will organize a roundtable with key representatives of the stakeholders to discuss recommendations concerning the use of this experience in the Ukrainian conditions. Subsequent to it, MFSI-II will provide assistance in preparing changes to the methodology for using the EITI standard in Ukraine.

*Deliverable: Develop a manual on EITI implementation in Ukraine and have it placed on the Project website*

*Timeline: January – March 2015*

MFSI-II experts have prepared a draft manual on EITI implementation in Ukraine. Among other things, this manual contains the information on the general foundations of EITI application, principles and format of EITI reports to be compiled by extractive enterprises about their operation and by the independent administrator about Ukraine in general, the budget process principles related to transparency of budget indicators for the general public, for them to be used for EITI purposes, and other essential information.

Following approval, according to the established order, of the legislative amendments required for EITI implementation, and of the Technical Specification for compiling the first EITI report, the abovementioned manual will be finalized and posted on the Project website.

See folder "Deliverables."

*Deliverable: Train MSG members and relevant non-member civil society organizations*

*Timeline: January – June 2015*

Training will be launched after adoption of the legislative amendments required for EITI implementation, approval of the Technical Specifications for compiling the first EITI report, and finalizing the manual on EITI implementation in Ukraine.

*Deliverable: Provide advisory services to MSG members, as necessary to facilitate in the preparation of EITI reports, including the development of a methodology for using the EITI standard in Ukraine*

*Timeline: January – September 2015*

MFSI-II experts presented their proposals and recommendations to MSG with regard to: the reporting template to be used by extractive companies for EITI purposes; amendments to the current legislation required for EITI implementation in Ukraine; and a manual for an independent auditor, which will be compiling an EITI report.

Among other things, the abovementioned recommendations contains the proposals to be incorporated into said documents pursuant to the current budget legislation and the budget process.

See folder “Deliverables.”

### **Task 6.2: Improve public awareness of the EITI and its importance for the Ukrainian citizens**

MFSI-II will select NGOs for training their representatives. Selection criteria will include the level of organizations’ activeness in cooperation with civil society over the last three years, etc. MFSI-II will provide at least 5 sub-grants to civil society organizations (including, but not limited to, MSG members) for the support of better public understanding, promotion of the EITI, supervision, transparency and disclosure of the extractive industries in order to strengthen the impact and coverage (including the geographical coverage) of the MSG’s efforts and activities. A wide range of civil society organizations will be in a position to apply for sub-grants, including those supporting mass media, energy sector, or anti-corruption, or proper public administration. The sub-grantee selection criteria will include the EITI coverage expansion capacity in terms of involving a greater number of NGOs and larger reporting on the extractive industries transparency agenda in mass media.

MFSI-II will ensure trainings on EITI implementation for the selected NGOs. Mass media will also be invited to them. If so necessary, MFSI-II will make field trips to have the said trainings conducted. MFSI-II will carry out a survey concerning the availability of civil society organizations engaged in the information support of civil society and will offer such entities to get involved in the Project as part of this task.

For the trainings, MFSI-II will make use of the manual to be developed under Task 6.1. Participation in them will be equally offered for women and men.

MFSI-II jointly with the selected civil society organizations will draw up an action plan on involving a wide range of civil society organizations into EITI implementation. That action plan will include training (MFSI-II jointly with the sub-grantees) for other civil society organizations from a given region. The selected civil society organizations (sub-grantees) will ensure conducting the trainings, for which use will be made of the manual to be developed under Task 6.1. Participation in them will be equally offered for women and men.

*Deliverable: Offer civil society organizations to participate in the selection for the Project as part of this task*

*Deliverable: Minutes on the selection of organizations for the Project*

*Timeline: July – September 2015*